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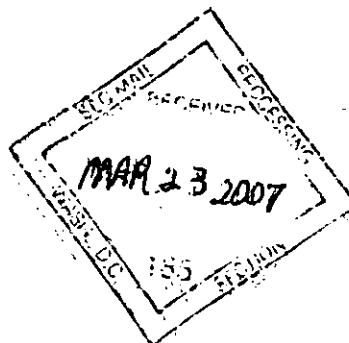
2006 Annual Report



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FINANCIAL



Setting our sights on future growth.

Barleysville National Corporation will be the financial advisor of choice by discovering customers' real financial needs and offering a complete value proposition of care and service during a lifetime relationship.

Our staff will accomplish this by working together as a team to develop a fully integrated solution delivered seamlessly through our retail, commercial and wealth management professionals.

We are committed to building shareholder value, while maintaining
- High level of integrity and adherence to our core corporate principles.



Deb M. Takes, Interim President and Chief Executive Officer

Dear Shareholders:

The past year was one of change at Harleysville National Corporation—new partners, new products and product enhancements and breaking ground on two new branch locations. Setting our sights on future growth, we will build upon these accomplishments, via our traditional retail and corporate banking units and Millennium Wealth Management and Private Banking.

Continued Strong Performance

Amongst these new developments, our team has stayed focused on delivering the financial results you expect from your company. Each change has been enacted with a watchful eye toward our bottom line. Our efficiency ratio continues to compare favorably to our peers and we remain committed to rewarding our shareholders. In addition to our steady dividend payouts in 2006, we also were honored for our performance by NASDAQ and The Staton Institute, gaining inclusion on NASDAQ's new Global Select Market and receiving "Earnings All-Star," "Dividend All-Star," "America's Smartest Companies," and "Super 50" Team" distinctions from Staton.

Achievements and Honors

- Total cash dividends paid and declared during 2006 were \$.752 per share, a 5.0% increase from the \$.718 per share paid last year. *Dividend numbers have been adjusted to reflect the 5% common stock dividend paid in September 2006 and September 2005.*
- We were named inaugural members of the new NASDAQ Global Select Market, the highest-ranking tier for NASDAQ-listed companies.
- For the sixteenth year in a row, Harleysville National Corporation was recognized in *America's Finest Companies*, an investment guide produced by The Staton Institute, Inc. Less than two percent of the nation's 19,000 public corporations are selected for inclusion in the guide.

Cornerstone Companies

On January 13, 2006, we completed our acquisition of the Cornerstone Companies, registered investment advisors for high net worth, privately held business owners, wealthy families and institutional clients. Located in Lehigh Valley, Pennsylvania, the firm specializes in providing sophisticated open architecture asset management platforms, business succession and estate planning services, life insurance sales and compensation and benefits consulting. Cornerstone has played a leading role in growing our noninterest income. Their unique approach and broad range of services have helped us add value for our current wealth management customers by introducing new services such as succession planning, employee benefits management and insurance sales to our commercial customers, further deepening our relationships with them.

Growing our Commercial Banking Focus

In an effort to support our growth and help drive major strategic initiatives, we've made several key enhancements to our commercial banking unit. Major developments include a strengthened focus on commercial real estate lending and the implementation of a streamlined commercial loan approval process by modifying lending authorities and adding more specific definition to the commercial chain of approval.

Last April, Gary Fox joined Harleysville National Bank as Senior Vice President, Commercial Real Estate Manager. Since then, Gary, under the direction of Executive Vice President and Chief Lending Officer, Lewis Cyr, has led the effort to manage our commercial real estate portfolio by growing new relationships and expanding our offerings to current customers. With the dedicated focus of Gary and his team, we are committed to maintaining strong credit quality.

To help accelerate the commercial loan approval process, we implemented a Small Business Application Processing System. This system allows us to process small business applications up to \$250,000 and render the decision in a fraction of the time it used to take—in most cases the same day. This streamlined process will allow our lenders to focus on growing and maintaining relationships, while offering our commercial and small business customers the convenience and service they deserve.

To further improve our responsiveness to borrowers, boost efficiency and better assess and manage loan risk, we updated our commercial lending organizational structure and commercial loan approval process. The key changes involve more reliance on those bankers closest to the borrower and less on a committee approach, allowing structural and risk issues to be addressed sooner, and hastening the decision-making process, both to the customer's and our benefit. The culmination of these commercial enhancements will provide us with the tools we need to focus on delivering results within this strategic growth area.

Adding Value Through Relationships

Our Millennium Wealth Management group made significant inroads in growing relationships with their respective customer base, adding to our bottom line. They have accomplished this via the many trust, benefits, insurance, succession planning, consulting and investment management offerings provided for business owners and high net worth clients through the trust and investment management area. To add value to our wealth management offerings, we recently introduced Delaware Trust capabilities. Delaware's favorable tax laws offer a host of advantages to wealthy individuals, corporate executives and professionals in the form of reduced tax liability and asset protection. Because Millennium is one of a select few organizations to offer the Delaware Advantage, we can present a significant differentiating value to our customers. We will continue to explore new ways to add to our range of wealth management products and services, including acquisition and partnership opportunities with wealth management organizations.

To support our commercial initiatives and grow new wealth management relationships, we welcomed some new members to the Millennium Wealth management team. We recently appointed three new managing directors to lead Millennium's Trust, Investment Management and Private Banking divisions. Longtime employee, Walter W. Henkel, CFC, was appointed Managing Director of Trust Services, overseeing Millennium's Trust and Estate Settlement areas, supervising the Trust group staff and growing and maintaining customer relationships. A 45-plus year veteran of the financial services industry, Walter has the knowledge and experience to serve our customers well. James E. Quillen, CFP®, assumed the role of Managing Director, Investment Management. Jim has been with Millennium for several years, actively contributing to the creation and management of its investment policy, while providing financial planning services to high net worth clients. Carol R. Coles, former Corporate Lending Manager and Commercial Credit Product Manager for Harleysville National Bank, has taken on the role of Managing Director, Private Banking. Her commercial credit and relationship management skills made her a fine choice for handling business investment loans, personal and commercial mortgages, home equity loans and business transition loans in a private banking service environment. Together with our entire Millennium team, each will play a leading role in giving valuable exposure to our total capabilities, a continuing key growth area for 2007.



New branch offices will look similar to the one above. Inside, customers will see fresh signage, new technology and eye-catching messages.

Market Expansion

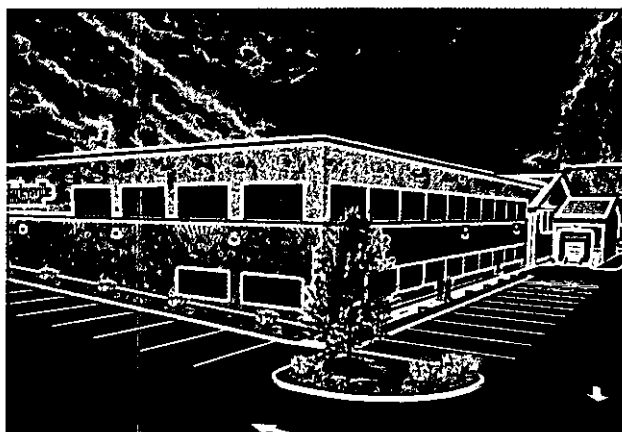
Another focus for relationship growth is market expansion. Through our market evaluation process, we identified further expansion within Bucks and Montgomery Counties as a priority. The markets' demographics and projected growth statistics offer valuable opportunities to build retail, commercial and wealth management relationships. Previously announced plans to build a new location in Warminster, Bucks County, are underway with an anticipated spring 2007 opening. The office is currently under roof at its location, near the intersection of Street and Jacksonville Roads. We are happy to report that we located another Bucks County site and plan to construct a branch at the intersection of Titus and Easton Roads (Route 611) in Warrington. We project a 2008 opening. In Montgomery County, we will open a new office in East Norriton—at 450 East Germantown Pike—in mid-2007. We have also signed a lease and will relocate our Blue Bell office to the intersection of Route 73 (Skippack Pike) and Butler Pike. The relocation to a more accessible spot with additional space and multiple drive-up banking lanes will help us better serve our customers. A site near the intersection of Ridge and Butler Pikes, Conshohocken, has also been secured, with a projected 2008 opening.

The last four aforementioned branches and future offices will be constructed using our new prototype design, finalized in 2006. The exteriors feature very similar designs, for ease in identification, while each interior includes space for retail, commercial and wealth management, making it easier to support and promote a total banking relationship. In addition to the design, the branches will all boast innovative merchandising utilizing fresh signage, new technology and eye-catching messages.

Corporate Campus Expansion: Enhancing Our Efficiency

Over the past year we have periodically updated you on the progress of our corporate campus construction project. The addition to our operations center is on schedule and set to open this spring. The project includes a 32,000 square-foot, two-story addition to the building that currently houses our customer support area and relocates our drive-up teller lanes, adding a drive-up ATM and improving the flow of traffic at our Harleysville headquarters. The addition will position us to better serve our growing market and customer base by consolidating departments currently housed at multiple satellite locations, boosting efficiencies and streamlining processes. Our loan operations, information systems, training and mortgage department employees, to name a few, are eagerly anticipating the move. We all look forward to gaining greater efficiency by significantly

minimizing travel time between locations, barriers to team collaboration, satellite office space overhead and added processes to accommodate various locations.



Our new operations center is scheduled to open in spring 2007.

Setting Our Sights on Future Growth

Using the infrastructure developed in 2006, our sights are set on future growth. The pieces are in place and we are poised to build core deposits, commercial loans and fee income through our retail, commercial and wealth management areas. Product and service enhancements, increasing our commercial loan portfolio, growing our fee-based business lines, expanding our horizons and executing on targeted cross-selling initiatives will all be key tactics to accomplishing our goals.

Throughout 2007, we will remain committed to building shareholder value and will be ever-mindful of maintaining the strong level of performance you have come to expect from Harleysville National Corporation. Preserving credit quality, keeping a bottom-line focus and retaining our core values will be top-of-mind as we position ourselves for the future. It has been my sincere pleasure serving you as Interim President and CEO these past months. I appreciate your continued loyalty and support and will strive to maintain your confidence throughout 2007.

Sincerely,

Deb M. Takes
Interim President and CEO

Financial Ratios and Summary of Key Information

Year ended December 31,

Dollars in thousands, except per share data

2006 2005 2004

Per Share Information*

| | | | |
|--------------------------------|--------|--------|--------|
| Basic earnings | \$1.36 | \$1.34 | \$1.35 |
| Diluted earnings | 1.34 | 1.32 | 1.31 |
| Cash dividends paid | 0.75 | 0.72 | 0.65 |
| Book value (at year-end) | 10.18 | 9.48 | 9.34 |

Market Value*

| | | | |
|---|------------|------------|------------|
| High closing price of common stock | \$24.90 | \$23.77 | \$26.92 |
| Low closing price of common stock | \$18.06 | \$17.83 | \$19.27 |
| Basic average common shares outstanding..... | 28,946,847 | 28,891,412 | 28,505,392 |
| Diluted average common shares outstanding | 29,353,128 | 29,490,216 | 29,465,613 |

Average Balance Sheet

| | | | |
|--|-------------|-------------|-------------|
| Loans | \$2,014,420 | \$1,900,023 | \$1,625,419 |
| Earning assets | 3,019,725 | 2,854,826 | 2,608,393 |
| Total assets | 3,229,224 | 3,039,186 | 2,773,405 |
| Deposits | 2,469,514 | 2,259,831 | 2,094,998 |
| Interest-bearing liabilities and demand deposits | 2,904,452 | 2,716,430 | 2,467,139 |
| Shareholders' equity | 281,847 | 272,974 | 251,963 |

Selected Ratios

| | | | |
|---|--------|--------|--------|
| Return on average assets | 1.22% | 1.28% | 1.39% |
| Return on average shareholders' equity | 13.98% | 14.22% | 15.31% |
| Leverage (assets divided by shareholders' equity) | 11.03 | 11.41 | 11.18 |
| Average shareholders' equity as a percentage of: | | | |
| Average loans | 13.99% | 14.37% | 15.50% |
| Average deposits | 11.41 | 12.08 | 12.03 |
| Average assets | 8.73 | 8.98 | 9.08 |
| Average earning assets | 9.33 | 9.56 | 9.66 |
| Dividend payout ratio | 55.26 | 53.41 | 48.16 |
| Average total loans as a percentage | | | |
| of average deposits and borrowed funds | 69.36 | 69.95 | 65.88 |
| Yield on earning assets** | 6.13 | 5.54 | 5.18 |
| Cost of interest bearing funds | 3.72 | 2.71 | 1.98 |
| Net interest margin** | 2.95 | 3.27 | 3.55 |

*Adjusted for a five percent stock dividend effective 9/15/06, 9/15/05 and 9/15/04.

**Tax Equivalent Basis (tax rate of 35%).



**2006 ANNUAL REPORT
ON FORM 10-K**

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-K

(Mark One)

☒ Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2006.

OR

☐ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____

Commission file number 0-15237

Harleysville National Corporation

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of
incorporation or organization)

483 Main Street,
Harleysville, Pennsylvania
(Address of principal executive offices)

23-2210237
(I.R.S. Employer
Identification No.)

19438
(Zip Code)

Registrant's telephone number, including area code: (215) 256-8851

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class
Common Stock, \$1.00 par value

Name of Each Exchange on Which Registered
The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☒

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The aggregate market value of the Registrant's Common Stock held by non-affiliates is \$532,364,576 based on the June 30, 2006 closing price of the Registrant's Common Stock of \$20.20 per share (restated for stock dividend paid on September 15, 2006).

As of March 7, 2007, there were 28,967,135 outstanding shares of the Registrant's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE:

1. Portions of the Registrant's Definitive Proxy Statement relating to the Annual Meeting of Shareholders to be held April 24, 2007 are incorporated by reference into Part III, Items 10-14 of this report.

HARLEYSVILLE NATIONAL CORPORATION

FORM 10-K

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Forward-Looking Statements

In addition to historical information, this report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We have made forward-looking statements in this report, and in documents that we incorporate by reference, that are subject to risks and uncertainties. Forward-looking statements include the information concerning possible or assumed future results of operations of Harleysville National Corporation and its subsidiaries. When we use words such as "believes," "expects," "anticipates," "may," "estimates," or "intends" or similar expressions, we are making forward-looking statements. Forward-looking statements are representative only as of the date they are made, and the Corporation undertakes no obligation to update any forward-looking statement.

Shareholders should note that many factors, some of which are discussed elsewhere in this report and in the documents that we incorporate by reference, could affect the future financial results of the Corporation and its subsidiaries and could cause those results to differ materially from those expressed or implied in our forward-looking statements contained or incorporated by reference in this document. These factors include but are not limited to those described in Item 1A, "Risk Factors."

PART I

Item 1. Business

Harleysville National Corporation (the Corporation), a Pennsylvania corporation, was incorporated June 1, 1982. On January 1, 1983, the Corporation became the parent bank holding company of Harleysville National Bank and Trust Company (the Bank or Harleysville National Bank), established in 1909, a wholly owned subsidiary of the Corporation. The Corporation is registered as a bank holding company under the Bank Holding Company Act of 1956.

Since commencing operations, the Corporation's business has consisted primarily of providing financial services through its subsidiaries and has acquired seven financial institutions since 1991 and also completed the acquisition of the Cornerstone Companies (registered investment advisors) in January 2006. The Corporation is also the parent holding company of HNC Financial Company and HNC Reinsurance Company. HNC Financial Company was incorporated on March 17, 1997 as a Delaware Corporation and its principal business function is to expand the investment opportunities of the Corporation. HNC Reinsurance Company was incorporated on March 30, 2001 as an Arizona Corporation and reinsures consumer loan credit life and accident and health insurance.

The Bank is a national banking association under the supervision of the Office of the Comptroller of the Currency (the OCC). The Corporation's and the Bank's legal headquarters are located at 483 Main Street, Harleysville, Pennsylvania 19438. HNC Financial Company's legal headquarters is located at 2751 Centerville Road, Suite 3164, Wilmington, Delaware 19808. HNC Reinsurance Company's legal headquarters is located at 101 North First Avenue, Suite 2460, Phoenix, AZ 85003.

The Bank provides a full range of banking services including loans and deposits, investment management and trust and investment advisory services to individual and corporate customers located primarily in eastern Pennsylvania. The Bank engages in the full-service commercial banking and trust business, including accepting time and demand deposits, making secured and unsecured commercial and consumer loans, financing commercial transactions, making construction and mortgage loans and performing corporate pension and personal investment and trust services. Deposits are insured by the Federal Deposit Insurance Corporation (FDIC) to the extent provided by law. The Bank has 45 branch offices located in Montgomery, Bucks, Chester, Berks, Carbon, Lehigh, Monroe, and Northampton counties, Pennsylvania.

The Bank enjoys a stable base of core deposits and is a leading community bank in its service areas. The Bank believes it has gained its position as a result of a customer-oriented philosophy and a strong commitment to service. Senior management has made the development of a sales orientation throughout the Bank one of their highest priorities and emphasizes this objective with extensive training and sales incentive programs. The Bank maintains close contact with the local business community to monitor commercial lending needs and believes it responds to customer requests quickly and with flexibility. Management believes these competitive strengths are reflected in the Corporation's results of operations.

The Bank opened a new location in the Peter Becker Community in Harleysville, Montgomery County during the third quarter of 2006. The office offers retail banking services and wealth management solutions. The Bank plans to open new retail branches in Warminster, Bucks County and East Norriton, Montgomery County as well as to relocate its Blue Bell office in Montgomery County during 2007. In addition, the Bank plans to add retail branches in Warrington, Bucks County and Conshohocken, Montgomery County in 2008. The Bank continues to evaluate potential new branch sites that are contiguous to our current service area and will expand the Bank's market area and market share of loans and deposits.

The Corporation is nearing completion of its corporate campus construction project to expand the operations center building located in Harleysville, Pennsylvania. This will increase efficiency by consolidating several departments whose employees are dispersed at multiple locations. Another strategic initiative for the Bank during 2007 is the offering of trust administration services, through its Millennium Wealth Management division, in the

state of Delaware which provides customers with reduced tax liability and asset protection. The Bank established a new Delaware trust office in October 2006 in order to provide customers with the favorable "Delaware Advantage."

The Corporation has two reportable operating segments: Community Banking and Wealth Management (including the Cornerstone Companies acquired in January 2006) as well as certain other non-reportable segments. As of December 31, 2006, the Wealth Management segment had assets under management of \$3.0 billion. Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information" establishes standards for the way public business enterprises report information about operating segments. Operating segments are components of an enterprise, which are evaluated regularly by the chief operating decision-maker in deciding how to allocate and assess resources and performance. The Corporation's chief operating decision-maker is the President and Chief Executive Officer. For more detailed financial information pertaining to operating segments, see Item 8— Note 17 of the Consolidated Financial Statements which is herein incorporated by reference.

Effective January 1, 2006, the Bank completed its acquisition of the Cornerstone Companies, registered investment advisors for high net worth, privately held business owners, wealthy families and institutional clients. Located in the Lehigh Valley, Pennsylvania, the firm specializes in providing sophisticated open architecture asset management platforms, business succession and estate planning services, life insurance sales and compensation and benefits consulting. The Cornerstone Companies had assets under management of approximately \$1.5 billion at the acquisition date and serve clients throughout Pennsylvania and other mid-Atlantic states.

The acquisition was consummated pursuant to the Purchase Agreement dated November 15, 2005, by and among the Bank and Cornerstone Financial Consultants, Ltd., a Pennsylvania corporation (CFC), Cornerstone Institutional Investors, Inc., a Pennsylvania corporation (CII), Cornerstone Advisors Asset Management, Inc., a Pennsylvania corporation (CAAM), and together with CFC and CII collectively, the Cornerstone Companies) and Cornerstone Management Resources, Inc., (CMR). Under the Purchase Agreement, the Bank acquired (i) all of the outstanding capital stock of CFC and CII, (ii) substantially all of the assets of CAAM, and (iii) certain limited assets of CMR. The purchase price consisted of \$15.0 million in cash paid at closing and a contingent payment of up to \$7.0 million to be paid post-closing. The contingent payment is based upon the Cornerstone Companies meeting certain minimum operating results during a five-year earn-out period with a maximum payout of \$7.0 million over this period. For 2006, the minimum operating results were met resulting in an earn-out payment of \$1.0 million which was recorded as additional goodwill. At December 31, 2006, the remaining maximum payout is \$6.0 million through 2010.

The Cornerstone Companies acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations." The Cornerstone Companies results of operations are included in the Corporation's results beginning January 1, 2006 through December 31, 2006. The Cornerstone Companies have become part of the Millennium Wealth Management segment of the Bank. The acquisition is expected to provide significant strategic advantages to the Corporation, broadening wealth management products and services, growing our business client base and positioning the Millennium Wealth Management division as a leader in our market.

On November 10, 2006, the Bank completed the sale of its Honesdale branch located in Wayne County, Pennsylvania with deposits of \$74.2 million, as well as loans and other assets of \$22.5 million to First National Community Bank. The sale of this single Wayne County location will allow the Bank to focus on expanding within its core markets and also help to provide the resources required to support strategic initiatives.

On April 14, 2006, the Bank sold its existing credit card portfolio to Elan Financial Services, a national credit card issuer and established an agent issuing relationship with Elan Financial Services. Under the agreement, credit cards for the Bank will be issued under the Harleysville National Bank name. The Bank sold \$15.3 million in credit card receivables.

On June 30, 2005, the Bank sold its former subsidiary, Cumberland Advisors, Inc. Cumberland Advisors, based in Vineland, New Jersey, is a SEC registered investment advisor specializing in fixed income money management and equities. It was acquired by the Corporation on April 30, 2004 as part of its Millennium Bank acquisition.

On April 30, 2004, the Corporation completed its acquisition of Millennium Bank, which was merged with and into the Bank. Millennium Bank was based in Malvern, Pennsylvania with four banking offices, specializing in commercial lending and client relationship banking along with Cumberland Advisors, Inc.

As of December 31, 2006, the Corporation had total assets of \$3.2 billion, total shareholders' equity of \$294.8 million and total deposits of \$2.5 billion.

As of December 31, 2006, the Corporation and the Bank employed approximately 740 full-time equivalent employees. The Corporation provides a variety of employment benefits and considers its relationships with its employees to be satisfactory.

Competition

The Bank competes actively with other eastern Pennsylvania financial institutions, many larger than the Bank, as well as with financial and non-financial institutions headquartered elsewhere. Commercial banks, savings banks, savings and loan associations, credit unions, and money market funds actively compete for deposits and loans. Such institutions, as well as consumer finance, insurance companies and brokerage firms, may be considered competitors with respect to one or more services they render. The Bank is generally competitive with all competing institutions in its service areas with respect to interest rates paid on time and savings deposits, service charges on deposit accounts, interest rates charged on loans and fees for trust and investment advisory services. At December 31, 2006, the Bank's legal lending limit to a single customer was \$41.9 million. Many of the institutions with which the Bank competes are able to lend significantly more than this amount to a single customer.

Concentrations/Seasonality

The Corporation and its subsidiaries do not have any portion of their businesses dependent on a single or limited number of customers, the loss of which would have a material adverse effect on the Corporation's business. No substantial portion of investments is concentrated within a single industry or group of related industries. The Corporation had no concentrations of credit extended to any specific industry that exceeded 10% of total loans at December 31, 2006. The businesses of the Corporation and its subsidiaries are not typically seasonal in nature.

Supervision and Regulation—The Registrant

The Gramm-Leach-Bliley Financial Modernization Act of 1999 (Modernization Act) allows bank holding companies meeting management, capital, and Community Reinvestment Act standards to engage in a substantially broader range of non-banking activities than permissible before enactment, including underwriting insurance and making merchant banking investments in commercial and financial companies. It allows insurers, and other financial services companies to acquire banks, removes various restrictions that currently apply to bank holding company ownership of securities firms and mutual fund advisory companies, and establishes the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations.

The Modernization Act also modified law related to financial privacy and community reinvestment. The privacy provisions generally prohibit financial institutions, including the Corporation, from disclosing nonpublic financial information to nonaffiliated third parties unless customers have the opportunity to "opt out" of the disclosure.

Pending Legislation

Management is not aware of any other current specific recommendations by regulatory authorities or proposed legislation which, if they were implemented, would have a material adverse effect upon the liquidity,

capital resources, or results of operations, although the general cost of compliance with numerous federal and state laws and regulations does have, and in the future may have, a negative impact on the Corporation's results of operations.

Effects of Inflation

Inflation has some impact on the Corporation's and the Bank's operating costs. Unlike many industrial companies, however, substantially all of the Bank's assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on the Corporation's and the Bank's performance than the general level of inflation. Over short periods of time, interest rates may not necessarily move in the same direction or in the same magnitude as prices of goods and services.

Effect of Government Monetary Policies

The earnings of the Corporation are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. An important function of the Federal Reserve is to regulate the money supply and interest rates. Among the instruments used to implement those objectives are open market operations in United States government securities and changes in reserve requirements to member bank deposits. These instruments are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may also affect rates charged on loans or paid for deposits.

The Bank is a member of the Federal Reserve and, therefore, the policies and regulations of the Federal Reserve have a significant effect on its deposits, loans and investment growth, as well as the rate of interest earned and paid, and are expected to affect the Bank's operations in the future. The effect of such policies and regulations upon the future business and earnings of the Corporation and the Bank cannot be predicted.

Environmental Regulations

There are several federal and state statutes which regulate the obligations and liabilities of financial institutions pertaining to environmental issues. In addition to the potential for attachment of liability resulting from its own actions, a bank may be held liable under certain circumstances for the actions of its borrowers, or third parties, when such actions result in environmental problems on properties that collateralize loans held by the bank. Further, the liability has the potential to far exceed the original amount of a loan issued by the bank. Currently, neither the Corporation nor the Bank are a party to any pending legal proceeding pursuant to any environmental statute, nor are the Corporation and the Bank aware of any circumstances that may give rise to liability under any such statute.

Supervision and Regulation—Bank

The operations of the Bank are subject to federal and state statutes applicable to banks chartered under the banking laws of the United States, to members of the Federal Reserve and to banks whose deposits are insured by the FDIC. The Bank's operations are also subject to regulations of the OCC, the Federal Reserve and the FDIC. The primary supervisory authority of the Bank is the OCC, who regularly examines the Bank. The OCC has authority to prevent a national bank from engaging in unsafe or unsound practices in conducting its business.

Federal and state banking laws and regulations govern, among other things, the scope of a bank's business, the investments a bank may make, the reserves against deposits a bank must maintain, loans a bank makes and collateral it takes, the activities of a bank with respect to mergers and consolidations and the establishment of branches.

The Corporation and the Bank are subject to regulations of certain state and federal agencies and, accordingly, these regulatory authorities periodically examine the Corporation and the Bank. As a consequence of the extensive regulation of commercial banking activities, the Corporation's and the Bank's business is susceptible to being affected by state and federal legislation and regulations.

As a subsidiary bank of a bank holding company, the Bank is subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to the bank holding company or its subsidiaries, or investments in the stock or other securities as collateral for loans. The Federal Reserve Act and Federal Reserve regulations also place certain limitations and reporting requirements on extensions of credit by a bank to principal shareholders of its parent holding company, among others, and to related interests of such principal shareholders. In addition, such legislation and regulations may affect the terms upon which any person becoming a principal shareholder of a holding company may obtain credit from banks with which the subsidiary bank maintains a correspondent relationship.

Under the Federal Deposit Insurance Act, the OCC possesses the power to prohibit institutions regulated by it (such as the Bank) from engaging in any activity that would be an unsafe and unsound banking practice or would otherwise be in violation of the law.

Community Reinvestment Act

Under the Community Reinvestment Act, the OCC is required to assess the record of all financial institutions regulated by it to determine if these institutions are meeting the credit needs of the community, including low and moderate income neighborhoods which they serve and to take this record into account in its evaluation of any application made by any of such institutions for, among other things, approval of a branch or other deposit facility, office relocation, a merger or an acquisition of bank shares. The Financial Institutions Reform, Recovery and Enforcement Act amended the CRA to require, among other things, that the OCC make publicly available the evaluation of a bank's record of meeting the credit needs of its entire community, including low and moderate income neighborhoods. This evaluation will include a descriptive rating like "outstanding," "satisfactory," "needs to improve" or "substantial noncompliance" and a statement describing the basis for the rating. These ratings are publicly disclosed.

Bank Secrecy Act

Under the Bank Secrecy Act, banks and other financial institutions are required to report to the Internal Revenue Service currency transactions of more than \$10,000 or multiple transactions of which a bank is aware in any one day that aggregate in excess of \$10,000 and to report suspicious transactions under specified criteria. Civil and criminal penalties are provided under the Bank Secrecy Act for failure to file a required report, for failure to supply information required by the Bank Secrecy Act or for filing a false or fraudulent report.

Capital Requirements / FDICIA

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires that institutions be classified, based on their risk-based capital ratios into one of five defined categories, as illustrated below: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under these guidelines, the Bank was considered well capitalized as of December 31, 2006.

| Capital category | Total Risk Based Ratio | Tier 1 Risk Based Ratio | Tier 1 Leverage Ratio | Under a Capital Order or Directive |
|--------------------------------|------------------------|-------------------------|-----------------------|------------------------------------|
| Well capitalized | ≥10.0% | ≥6.0% | ≥5.0% | NO |
| Adequately capitalized | ≥8.0% | ≥4.0% | ≥4.0%(1) | |
| Undercapitalized | <8.0% | <4.0% | <4.0%(1) | |
| Significantly undercapitalized | <6.0% | <3.0% | <3.0% | |
| Critically undercapitalized | | | <2.0% | |

(1) 3.0 for those banks having the highest available regulatory rating.

In the event an institution's capital deteriorates to the undercapitalized category or below, FDICIA prescribes an increasing amount of regulatory intervention, including: the institution of a capital restoration plan and a guarantee of the plan by a parent institution; and the placement of a hold on increases in assets, number of branches or lines of business. If capital has reached the significantly or critically undercapitalized levels, further material restrictions can be imposed, including restrictions on interest payable on accounts, dismissal of management and, in critically undercapitalized situations, appointment of a receiver. For well capitalized institutions, FDICIA provides authority for regulatory intervention where the institution is deemed to be engaging in unsafe or unsound practices or receives a less than satisfactory examination report rating for asset quality, management, earnings or liquidity. All but well capitalized institutions are prohibited from accepting brokered deposits without prior regulatory approval.

Under FDICIA, financial institutions are subject to increased regulatory scrutiny and must comply with certain operational, managerial and compensation standards to be developed by Federal Reserve Board regulations. FDICIA also requires the regulators to issue new rules establishing certain minimum standards to which an institution must adhere including standards requiring a minimum ratio of classified assets to capital, minimum earnings necessary to absorb losses and minimum ratio of market value to book value for publicly held institutions. In addition, FDICIA requires regulators to develop standards relating to internal controls, loan documentation, credit underwriting, interest rate exposure, asset growth and excessive compensation, fees and benefits.

Annual full-scope, on site regulatory examinations are required for all the FDIC-insured institutions except institutions with assets under \$250 million which are well-capitalized; well-managed and not subject to a recent change in control, in which case, the examination period may be every 18 months. Banks with total assets of \$500 million or more are required to submit to their supervising federal and state banking agencies a publicly available annual audit report. The independent accountants of banks with total assets of \$1 billion or more are required to attest to the accuracy of management's report regarding the internal controls of the bank. In addition, such banks also are required to have an independent audit committee composed of outside directors who are independent of management, to review with management and the independent accountants, the reports that must be submitted to the bank regulatory agencies. If the independent accountants resign or are dismissed, written notification must be given to the bank's supervising government banking agencies.

FDICIA also requires that banking agencies reintroduce loan-to-value ratio regulations which were, previously repealed by the 1982 Act. Loan-to-values limit the amount of money a financial institution may lend to a borrower, when the loan is secured by real estate, to no more than a percentage, set by regulation, of the value of the real estate.

A separate subtitle within FDICIA, called the "Bank Enterprise Act of 1991," requires "truth-in-savings" on consumer deposit accounts so that consumers can make meaningful comparisons between the competing claims of banks with regard to deposit accounts and products. Under this provision, a bank is required to provide information to depositors concerning the terms of their deposit accounts, and in particular, to disclose the annual percentage yield.

Capital Distributions

The Corporation is a legal entity separate and distinct from its banking and other subsidiaries. The majority of the Corporation's revenue is from dividends paid to the Corporation by the Bank. The Bank is subject to various regulatory policies and requirements relating to the amount and frequency of dividend declarations. Future dividend payments to the Corporation by the Bank will be dependent on a number of factors, including the earnings and financial condition of the Bank, and are subject to limitations and other statutory powers of bank regulatory agencies.

The National Banking Laws require the approval of the OCC if the total of all dividends declared by a national bank in any calendar year exceed the net profits of the bank for that year combined with its retained net profits for the preceding two calendar years. An insured depository institution is prohibited from making any capital distributions to its owner, including any dividend, if, after making such distribution, the depository

institution fails to meet the required minimum level for any relevant capital measure, including the risk-based capital adequacy and leverage standards previously discussed in the capital requirements section.

Deposit Insurance and Premiums

The Bank's deposits are insured by the Deposit Insurance Fund (DIF) effective March 31, 2006 which is administered by the FDIC. Prior to March 31, 2006, the Bank's deposits were insured by the Bank Insurance Fund (BIF). Pursuant to the Federal Deposit Insurance Reform Act of 2005, the FDIC merged the Bank Insurance Fund (BIF) and Savings Insurance Fund (SAIF) to form the Deposit Insurance Fund (DIF) effective March 31, 2006. On April 1, 2006, the FDIC issued an interim rule, made final in September 2006, to implement the deposit insurance coverage changes of the Federal Deposit Insurance Reform Act of 2005. The rule: (1) increased the deposit insurance limit for certain retirement plan deposits to \$250,000 effective April 1, 2006 (the basic insurance limit for other depositors such as individuals, joint accountholders, businesses, government entities and trusts remains at \$100,000 per depositor, per insured institution), (2) provides per-participant insurance coverage to employee benefit plan accounts, even if the depository institution at which the deposits are placed is not authorized to accept employee benefit plan deposits and (3) allows the FDIC to consider inflation adjustments to increase the insurance limits for all deposit accounts every five years, beginning in 2010. The insurance is backed by the full faith and credit of the United States government.

As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of, and to require reporting by, FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the insurance fund. The FDIC also has the authority to terminate an institution's deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

During 2006, deposit insurance premiums were assessed based both on the balance of insured deposits held as well as the degree of risk the institution poses to the insurance fund with a designated minimum reserve ratio of 1.25% of estimated insured deposits or such higher reserve ratio as established by the FDIC. Each insured institution was placed in one of nine risk categories based upon the institution's capital classifications and supervisory evaluation with risk classification of all insured institutions being made by the FDIC for each semi-annual assessment period. The premium schedule for former BIF insured institutions ranged from 0 to 27 basis points per \$100 of deposits depending on the assessment category into which the insured institution was placed. Banks classified as strongest by the FDIC were subject in 2006 to a 0.00% assessment. The Bank was placed in this category and, therefore, had a 0.00% assessment rate in 2006.

In addition, all insured institutions are required to pay a Financing Corporation (FICO) assessment. FICO is a government agency-sponsored entity that was formed to borrow money necessary to carry out the closing and disposition of failed thrift institutions in the 1980's. The annual FICO rate for all insured institutions as of December 31, 2006 was 1.24 basis points. These assessments are revised quarterly and will continue until the bonds mature in the year 2019. The Bank paid FICO premiums of \$307,000 in 2006.

On November 2, 2006, the FDIC set the designated reserve ratio for the deposit insurance fund at 1.25% of estimated insured deposits and adopted final regulations to implement the risk-based deposit insurance assessment system mandated by the Deposit Insurance Reform Act of 2005, which is intended to more closely tie each bank's deposit insurance assessments to the risk it poses to the deposit insurance fund. Under the new risk-based assessment system, the FDIC will evaluate each institution's risk based on three primary factors -- supervisory ratings for all insured institutions, financial ratios for most institutions, and long-term debt issuer ratings for large institutions that have them and consolidates the nine risk categories into four risk categories. An institution's assessment rate will depend upon the level of risk it poses to the deposit insurance system as measured by these factors. The new rates range from 5 to 43 basis points and most institutions will vary between 5 and 7 cents for every \$100 of domestic insurable deposits.

The new assessment rates will take effect at the beginning of 2007. However, the Deposit Insurance Reform Act of 2005 provides credits to institutions that paid high premiums in the past to bolster the FDIC's insurance reserves, as a result of which the FDIC has announced that a majority of banks will have assessment credits to initially offset all of their premiums in 2007. Management estimates the Bank's assessment rate will be

approximately 5.4 basis points, or \$1.4 million, for 2007 based on data as of December 31, 2006. The Bank's one-time assessment credit is approximately \$1.4 million which will be available to offset the initial assessment in 2007. Any significant increases in assessment rates or additional special assessments by the FDIC could have an adverse impact on the results of operations and capital of the Bank and the Corporation.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 implemented a broad range of corporate governance, accounting and reporting measures for companies that have securities registered under the Exchange Act, including publicly-held bank holding companies. The more significant reforms of the Sarbanes-Oxley Act of 2002 included: (1) new requirements for audit committees, including independence, expertise, and responsibilities; (2) certification of financial statements by the Chief Executive Officer and Chief Financial Officer of the reporting company; (3) new standards for auditors and regulation of audits, including independence provisions that restrict non-audit services that accountants may provide to their audit clients; (4) increased disclosure and reporting obligations for the reporting company and their directors and executive officers, including accelerated reporting of stock transactions and a prohibition on trading during pension blackout periods; (5) a range of new and increased civil and criminal penalties for fraud and other violations of the securities laws.

USA Patriot Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act) imposes additional obligations on financial institutions, including banks and broker-dealer subsidiaries, to implement policies, procedures and controls which are reasonably designed to detect and report instances of money laundering and the financing of terrorism. In addition, provisions of the USA Patriot Act require the federal financial institution regulatory agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing bank mergers and bank holding company acquisitions.

Supervision and Regulation - Cornerstone Companies

The Cornerstone Companies are subject to regulation by a number of federal regulatory agencies that are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of customers participating in those markets. The SEC is the federal agency that is primarily responsible for the regulation of broker-dealers and investment advisers doing business in the United States. The Federal Reserve Board promulgates regulations applicable to securities credit transactions involving broker-dealers and certain other institutions. Much of the regulation of CII, as a registered broker-dealer, however, has been delegated to self-regulatory organizations (SROs), principally the NASD (and its subsidiaries NASD Regulation, Inc. and the Nasdaq Stock Market), and the national securities exchanges. These SROs, which are subject to oversight by the SEC, adopt rules (which are subject to approval by the SEC) that govern the industry, monitor daily activity, and conduct periodic examinations of member broker-dealers.

CII, CFC and CAAM are registered as investment advisers with the SEC and are subject to the requirements of the Investment Advisers Act of 1940 and the SEC's regulations, as well as certain state securities laws and regulations. These requirements relate to limitations on the ability of an investment adviser to charge performance-based or non-refundable fees to clients, record-keeping and reporting requirements, disclosure requirements, limitations on principal transactions between an adviser or its affiliates and advisory clients, as well as general anti-fraud prohibitions. CII, as a broker-dealer registered with the SEC and as a member firm of the NASD, is subject to capital requirements of the SEC and the NASD. These capital requirements specify minimum levels of capital that CII is required to maintain and also limit the amount of leverage that it is able to obtain in its respective business.

In the event of non-compliance with an applicable regulation, governmental regulators and the NASD, if concerning CII, may institute administrative or judicial proceedings that may result in censure, fine, civil penalties, the issuance of cease-and-desist orders or the deregistration or suspension of the non-compliant broker-dealer or investment adviser or other adverse consequences. The imposition of any such penalties or orders on the

Cornerstone Companies could have a material adverse effect on the Cornerstone Companies' (and therefore the Corporation's) operating results and financial condition.

CII is a member of the Securities Investor Protection Corporation (SIPC), which is a non-profit corporation that was created by the United States Congress under the Securities Protection Act of 1970. SIPC protects customers of member broker-dealers against losses caused by the financial failure of the broker-dealer but not against a change in the market value of securities in customers' accounts at the broker-dealer. In the event of the inability of a member broker-dealer to satisfy the claims of its customers in the event of its failure, the SIPC's funds are available to satisfy the remaining claims up to maximum of \$500,000 per customer, including up to \$100,000 on claims for cash. In addition, CII's clearing firm, Pershing LLC, carries private insurance that provides unlimited account protection in excess of SIPC's protection.

Changes in Regulations

From time to time, various types of federal and state legislation have been proposed that could result in additional regulation of, and restriction on, the business of the Corporation and the Bank. It cannot be predicted whether any such legislation will be adopted or, if adopted, how such legislation would affect the business of the Corporation or the Bank. As a consequence of the extensive regulation of commercial banking activities in the United States, the Corporation and the Bank are particularly susceptible to being affected by federal legislation and regulations that may increase the costs of doing business.

Additional Information

The Corporation's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge on the Corporation's website (www.hnccbank.com under "Investor Information—Documents") as soon as reasonably practicable after the Corporation electronically files such material with, or furnishes it to the Securities and Exchange Commission. These filings are also accessible on the Securities and Exchange Commission's website (www.sec.gov). In addition, the Corporation makes available on www.hnccbank.com under "Investor Information—Corporate Governance" the following: 1) Audit Committee Charter, 2) Code of Ethics, which applies to all directors and all employees, 3) Whistleblower Policy, 4) Nominating and Corporate Governance Committee Charter and 5) Compensation Committee Charter.

Item 1A. Risk Factors

The business of the Corporation and the Bank involve significant risks as described below. Additional risks may arise in the future or risks that are currently not considered significant may also impact the operations of the Corporation and the Bank. The Corporation may amend or supplement the risk factors described below from time to time by reports filed with the SEC in the future. Management's ability to analyze and manage these and other risks could affect the future financial results of the Corporation. If any of the events or circumstances described in the following risks occurs, the financial condition or results of operations of the Corporation could suffer and the trading price of the Corporation's common stock could decline.

Interest rate movements impact the earnings of the Corporation.

The Corporation is exposed to interest rate risk, through the operations of its banking subsidiary, since substantially all of the Bank's assets and liabilities are monetary in nature. Interest rate risk arises from market driven fluctuations in interest rates that affect cash flows, income, expense and value of financial instruments. The Bank's earnings, like that of most financial institutions, largely depends on net interest income, which is the difference between the interest income earned on interest-earning assets, such as loans and investments, and the interest expense paid on interest-bearing liabilities, such as deposits and borrowings. In an increasing interest rate environment, the cost of funds is expected to increase more rapidly than the interest earned on the loans and securities because the primary source of funds are deposits with generally shorter maturities than the maturities on loans and investment securities. This causes the net interest rate spread to compress and negatively impacts the Bank's profitability. The Corporation actively manages its interest rate sensitivity positions. The objectives of

interest rate risk management are to control exposure of net interest income to risks associated with interest rate movements and to achieve consistent growth in net interest income.

The Corporation is exposed to risks in connection with loans the Bank makes and if the allowance for loan losses is not sufficient to cover actual loan losses, the Corporation's earnings could decrease.

A significant source of risk for the Corporation arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. The Corporation has underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that are believed to be adequate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying loan portfolios. Such policies and procedures, however, may not prevent unexpected losses that could adversely affect the Corporation's results of operations.

The Corporation maintains an allowance for loan losses at a level management believes is sufficient to absorb estimated probable credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires significant estimates by management. Consideration is given to a variety of factors in establishing these estimates including historical losses, current and anticipated economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, borrowers' perceived financial and management strengths, the adequacy of underlying collateral, the dependence on collateral, or the strength of the present value of future cash flows and other relevant factors. These factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required which may adversely affect the Corporation's results of operations in the future.

Strong competition within the Corporation's market area may limit its growth and profitability.

Competition in the banking and financial services industry is intense. The Bank competes actively with other eastern Pennsylvania financial institutions, many larger than the Bank, as well as with financial and non-financial institutions headquartered elsewhere. Commercial banks, savings banks, savings and loan associations, credit unions, and money market funds actively compete for deposits and loans. Such institutions, as well as consumer finance, insurance companies and brokerage firms, may be considered competitors with respect to one or more services they render. The Bank is generally competitive with all competing institutions in its service areas with respect to interest rates paid on time and savings deposits, service charges on deposit accounts, interest rates charged on loans and fees for trust and investment advisory services. Many of the institutions with which the Bank competes have substantially greater resources and lending limits and may offer certain services that the Bank does not or cannot provide. The Corporation's profitability depends upon the Bank's ability to successfully compete in its market area.

An economic downturn in eastern Pennsylvania or a general decline in economic conditions could adversely affect the Corporation's financial results.

The Bank's operations are concentrated in eastern Pennsylvania. As a result of this geographic concentration, the Corporation's financial results may correlate to the economic conditions in this area. Deterioration in economic conditions in this market area, particularly in the industries on which this geographic areas depend, or a general decline in economic conditions may adversely affect the quality of the loan portfolio (including the level of non-performing assets, charge offs and provision expense) and the demand for products and services, and accordingly, the Corporation's results of operations. Inflation has some impact on the Corporation's and the Bank's operating costs.

The Corporation operates in a highly regulated environment and may be adversely affected by changes in laws and regulations.

The Corporation and the Bank are subject to extensive regulation, supervision and examination by certain state and federal agencies including the Pennsylvania State Department of Banking, the Federal Deposit

Insurance Corporation, as insurer of the Bank's deposits, the Board of Governors of the Federal Reserve System, as regulator of the holding company and the Office of the Comptroller of Currency. Such regulation and supervision governs the activities in which an institution and its holding company may engage, and are intended primarily to ensure the safety and soundness of financial institutions. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of assets and determination of the level of the allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on the Bank's and the Corporation's operations. There are also several federal and state statutes which regulate the obligation and liabilities of financial institutions pertaining to environmental issues. In addition to the potential for attachment of liability resulting from its own actions, a bank may be held liable under certain circumstances for the actions of its borrowers, or third parties, when such actions result in environmental problems on properties that collateralize loans held by the bank. Further, the liability has the potential to far exceed the original amount of a loan issued by the bank.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The principal executive offices of the Corporation and of the Bank are located in Harleysville, Pennsylvania in a two-story office building owned by the Bank, built in 1929. The Bank also owns the buildings in which twenty-four of its branches are located (three branches to be opened during 2007 and 2008) and leases space for the other twenty-four branches from unaffiliated third parties under leases expiring at various times through 2036. The Bank leases office space for commercial business development in Lansdale, Pennsylvania. The Cornerstone Companies lease office space in Bethlehem, Pennsylvania. HNC Investment Company leases an office in Wilmington, Delaware. HNC Reinsurance Company leases an office in Phoenix, Arizona.

| Office | Office Location | Owned/Leased |
|---------------------------|--|----------------------|
| Harleysville Campus | 483 Main Street, Harleysville, PA | Owned |
| Harleysville-Meadowbrook | 278 Main Street, Harleysville, PA | Leased |
| Skippack | 3893 Skippack Pike, Skippack, PA | Owned |
| Limerick | 260 West Ridge Pike, Limerick, PA | Owned |
| North Wales | 1498 North Wales Road, North Wales, PA | Owned |
| Gilbertsville | 1050 East Philadelphia Avenue, Gilbertsville, PA | Leased |
| Hatfield | 1632 Cowpath Road, Hatfield, PA | Leased |
| Lansdale-North Broad | 1804 North Broad Street, Lansdale, PA | Owned |
| Lansdale-Marketplace | 1551 Valley Forge Road, Lansdale, PA | Leased |
| Normandy Farms | Morris Road & Route 202, Blue Bell, PA | Leased |
| Horsham | 955 Horsham Road, Horsham, PA | Leased |
| Meadowood | 3205 Skippack Pike, Worcester, PA | Leased |
| Collegeville | 364 East Main Street, Collegeville, PA | Owned |
| Sellersville | 209 North Main Street, Sellersville, PA | Owned |
| Trainers Corner | 120 North West End Boulevard, Quakertown, PA | Leased |
| Quakertown Main | 224 West Broad Street, Quakertown, PA | Owned |
| Spring House | 1017 North Bethlehem Pike, Spring House, PA | Owned |
| Red Hill | 400 Main Street, Red Hill, PA | Owned |
| Doylestown | 500 East Farm Lane, Doylestown, PA | Leased |
| Audubon | 2624 Egypt Road, Norristown, PA | Owned ⁽¹⁾ |
| Chalfont | 251 West Butler Avenue, Chalfont, PA | Leased |
| Royersford | 440 W. Linfield-Trappe Road, Royersford, PA | Owned ⁽¹⁾ |
| Souderton | 702 Route 113, Souderton, PA | Leased |
| Foulkeways | 1120 Meetinghouse Road, Gwynedd, PA | Leased |
| Malvern ⁽²⁾ | 30 Valley Stream Parkway, Malvern, PA | Leased |
| Malvern | 83 Lancaster Avenue, Malvern, PA | Leased |
| Blue Bell ⁽²⁾ | 721 Skippack Pike, Suite 100, Blue Bell, PA | Leased |
| Wyomissing ⁽²⁾ | 2800 State Hill Road, Wyomissing, PA | Owned |
| Lansford | 13-15 West Ridge Street, Lansford, PA | Owned |
| Summit Hill | 2 East Ludlow Street, Summit Hill, PA | Owned |
| Lehighton | 904 Blakeslee Blvd, Lehighton, PA | Owned |
| Slatington | 502 Main Street, Slatington, PA | Owned |
| Slatington Handi-Bank | 701-705 Main Street, Slatington, PA | Owned |
| Lehigh Township | 4421 Lehigh Drive, Walnutport, PA | Owned |
| Palmerton | 372 Delaware Avenue, Palmerton, PA | Owned |
| Kresgeville | Route 209, Kresgeville, PA | Leased |
| Allentown ⁽²⁾ | 1602 Allen Street, Allentown, PA | Leased |
| Pottstown-Train Station | One Security Plaza, Pottstown, PA | Leased |
| Pottstown-East End | 1450 East High Street, Pottstown, PA | Owned |
| Pottstown-North End | 930 North Charlotte Street, Pottstown, PA | Leased |
| Pottstown Center | Rt. 100 and Shoemaker Road, Pottstown, PA | Owned ⁽¹⁾ |
| Pottstown-Coventry | 2 Glocker Way, Pottstown, PA | Leased |

| Office | Office Location | Owned/Leased |
|------------------------------|---|----------------------|
| Boyertown | Rt. 100 and Baus Road, Boyertown, PA | Leased |
| Douglassville | 1191 West Ben Franklin Highway, Douglassville, PA | Leased |
| Dorneyville | 3570 Hamilton Boulevard, Allentown, PA | Leased |
| Warminster ⁽³⁾ | 190 Veterans Way, Warminster, PA | Owned ⁽¹⁾ |
| Peter Becker Community | 815 Maplewood Drive, Harleysville, PA | Leased |
| Warrington ⁽⁴⁾ | Titus and Easton Roads, Warrington, PA | Owned ⁽¹⁾ |
| East Norriton ⁽³⁾ | 450 East Germantown Pike, East Norriton, PA | Owned ⁽¹⁾ |

- (1) Branch buildings are owned by the Bank and the land is leased.
(2) Locations include Millennium Wealth Management and Private Banking offices.
(3) These branches are expected to open for business in 2007.
(4) This branch is expected to open for business in 2008.

In management's opinion, all of the above properties are in good condition and are adequate for the Registrant's and the Bank's purposes.

Item 3. Legal Proceedings

Management, based on consultation with the Corporation's legal counsel, is not aware of any litigation that would have a material adverse effect on the consolidated financial position of the Corporation. There are no proceedings pending other than the ordinary routine litigation incident to the business of the Corporation and its subsidiaries—the Bank, HNC Financial Company and HNC Reinsurance Company. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation and the Bank by government authorities.

Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted during the fourth quarter of 2006 to a vote of holders of the Corporation's Common Stock.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The following table sets forth high and low closing sales prices for the Corporation's common stock and quarterly cash dividends paid per share for 2006 and 2005. The Corporation's stock is traded under the symbol "HNBC" on the NASDAQ Global Select Market. All share information has been restated to reflect stock dividends and splits. For certain limitations on the Bank's ability to pay dividends to the Corporation, see Item 1, "Supervision and Regulation—Bank" and Item 8, Note 20, "Notes to Consolidated Financial Statements—Regulatory Capital."

Price of Common Stock and Cash Dividends

| | High Price | Low Price | Cash dividends per share |
|-------------------------|------------|-----------|-----------------------------|
| 2006 | | | |
| First Quarter(1) | \$24.90 | \$18.65 | \$0.18 |
| Second Quarter(1) | 21.80 | 18.06 | 0.18 |
| Third Quarter | 20.87 | 18.82 | 0.19 |
| Fourth Quarter | 21.72 | 19.22 | 0.20 |
| 2005 | | | |
| First Quarter(2) | \$23.77 | \$18.86 | \$0.16 |
| Second Quarter(2) | 22.36 | 17.83 | 0.17 |
| Third Quarter(1) | 23.10 | 20.00 | 0.17 |
| Fourth Quarter(1) | 21.67 | 18.11 | 0.22 |

(1) Adjusted for a five percent stock dividend effective 9/15/06.

(2) Adjusted for a five percent stock dividend effective 9/15/06 and 9/15/05.

At December 31, 2006, there were 3,561 shareholders of record, not including the number of persons or entities whose stock is held in nominee or "street" name through various brokerage firms and banks.

The Corporation has a stock repurchase program that permits the repurchase of up to five percent of its outstanding common stock. The repurchased shares will be used for general corporate purposes.

The following table provides information about purchases made by the Corporation of its common stock during the quarter ended December 31, 2006:

Issuer Purchases of Common Stock

| | Total Number of Common Shares Purchased | Weighted Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Maximum Number of Shares that may yet be Purchased under the Plans(1) |
|---------------------------|---|--|---|---|
| October 1-31, 2006 | 46,500 | \$21.25 | 46,500 | 919,261 |
| November 1-30, 2006 | — | — | — | 872,761 |
| December 1-31, 2006 | — | — | — | 872,761 |
| Total | <u>46,500</u> | <u>\$21.25</u> | <u>46,500</u> | |

(1) On May 12, 2005, the Board of Directors authorized a plan to purchase up to 1,416,712 shares (restated for five percent stock dividend paid on September 15, 2006 and September 15, 2005) or 4.9%, of its outstanding common stock.

Equity Compensation Plan Information

The following table provides information about shares of the Corporation's stock that may be issued under existing equity compensation plans as of December 31, 2006.

| Plan Category | Number Of Securities To Be Issued Upon Exercise Of Outstanding Options, Warrants And Rights (A) (#) | Weighted-Average Exercise Price Of Outstanding Options, Warrants And Rights (B) (\$) | Number Of Securities Remaining Available For Future Issuance Under Equity Compensation Plans; Excluding Securities Reflected In Column (A) (C) (#) |
|--|--|---|--|
| Equity Compensation Plans Approved by Stockholders | 1,157,485 ⁽¹⁾ | \$15.60 per share | 1,272,597 |
| Equity Compensation Plans Not Approved by Stockholders | -0 ⁽²⁾ | -0- | 23,043 |
| TOTAL | 1,157,485 | \$15.60 per share | 1,295,640 |

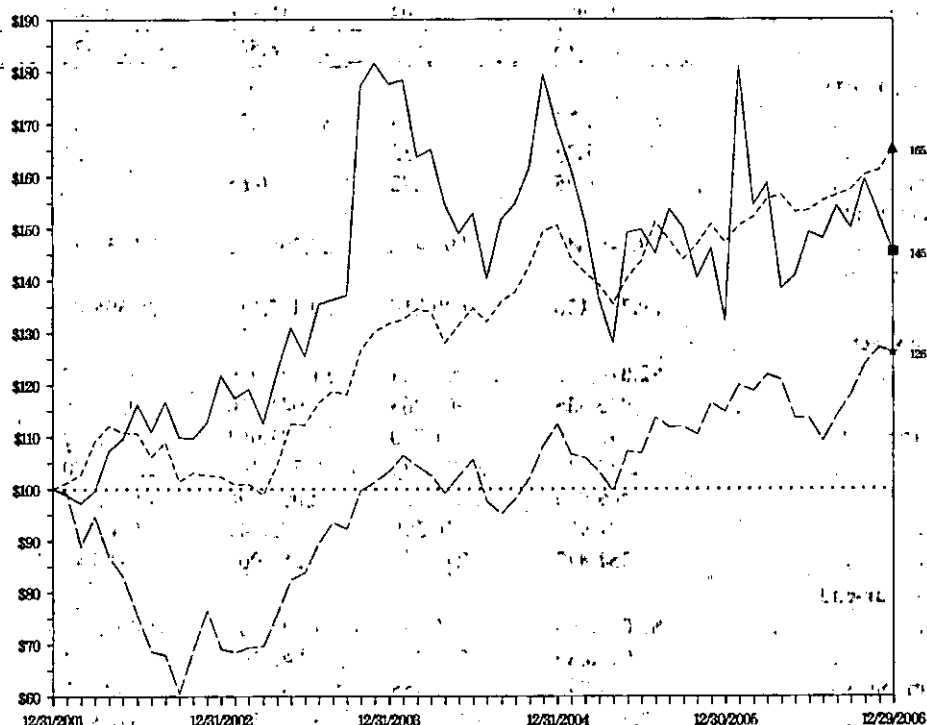
- (1) Includes options issued under the Corporation's 1993 and 1998 Stock Incentive Plans, 1998 Independent Director's Stock Option Plan, 2004 Omnibus Stock Incentive Plan and options assumed pursuant to the merger & acquisition of Millennium Bank on April 30, 2004.
- (2) On December 13, 1996, the Board of Directors authorized the registration of 70,354 shares of common stock for issuance under the HNC Employee Stock Bonus Plan. On December 24, 1996, in celebration of the Corporation reaching \$1 billion in total assets, 41,685 shares were issued to full and part-time employees of the Corporation's subsidiaries. Annually, since 1996, a total of 5,626 shares in the aggregate, have been awarded under this Plan to employees in recognition of exemplary service during each calendar year. When awarded, the value of shares is based on the closing price of HNC common stock as of the close of business on the last business day of the most recently completed calendar quarter. Registered shares and available shares under the Plan reflect adjustment for stock dividends.

Additional information on the Corporation's equity compensation plans included under Item 8, Note 1, "Notes to Consolidated Financial Statements—Stock-Based Compensation and Note 14, "Stock-Based Compensation," is incorporated herein by reference.

Shareholder Return Performance Graph

A line graph comparing the yearly change in the cumulative total shareholder return on the Corporation's common stock against the cumulative total return of the NASDAQ Stock Market (U.S. Companies) Index and the NASDAQ Bank Stocks Index for the period of 5 fiscal years commencing January 1, 2002, and ending December 31, 2006, follows. The shareholder return shown on the graph below is not necessarily indicative of future performance.

Comparison of Five-Year Cumulative Total Returns
Performance Graph for Harleyville National Corporation



Legend

| Symbol | CRSP Total Returns Index for: | 12/2001 | 12/2002 | 12/2003 | 12/2004 | 12/2005 | 12/2006 |
|--------|--|---------|---------|---------|---------|---------|---------|
| ■ | HARLEYSVILLE NATIONAL CORP | 100.0 | 121.8 | 177.5 | 169.4 | 132.1 | 145.6 |
| ★ | Nasdaq Stock Market (US Companies) | 100.0 | 69.1 | 103.4 | 112.5 | 114.9 | 126.2 |
| ▲ | Nasdaq Bank Stocks SIC 6020-6029, 6710-6719, US & Foreign | 100.0 | 102.4 | 131.7 | 150.7 | 147.2 | 165.2 |

Notes:

- The lines represent monthly index levels derived from compounded daily returns that include all dividends.
- The indexes are reweighted daily using the market capitalization on the previous trading day.
- If the monthly interval, based on the fiscal year-end, is not a trading day, the preceding trading day is used.
- The index level for all series was set to \$100.0 on 12/31/2001.

Prepared by CRSP (www.crsp.uchicago.edu), Center for Research in Security Prices, Graduate School of Business,
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Item 6. Selected Financial Data

| | Year Ended December 31, | | | | |
|-------------------------------------|--|-------------|-------------|-------------|-------------|
| | 2006(3) | 2005 | 2004(2) | 2003 | 2002 |
| | (Dollars in thousands, except per share information) | | | | |
| Income and expense | | | | | |
| Interest income | \$ 178,941 | \$ 151,739 | \$ 127,729 | \$ 119,200 | \$ 132,630 |
| Interest expense | 95,768 | 64,618 | 42,638 | 40,079 | 52,610 |
| Net interest income | 83,173 | 87,121 | 85,091 | 79,121 | 80,020 |
| Provision for loan losses | 4,200 | 3,401 | 2,555 | 3,200 | 4,370 |
| Net interest income after provision | | | | | |
| for loan losses | 78,973 | 83,720 | 82,536 | 75,921 | 75,650 |
| Noninterest income | 45,445 | 29,990 | 28,158 | 27,638 | 22,523 |
| Noninterest expense | 70,927 | 62,479 | 59,561 | 59,529 | 56,297 |
| Income before income tax expense | 53,491 | 51,231 | 51,133 | 44,030 | 41,876 |
| Income tax expense | 14,076 | 12,403 | 12,566 | 8,697 | 8,949 |
| Net income | \$ 39,415 | \$ 38,828 | \$ 38,567 | \$ 35,333 | \$ 32,927 |
| Per share information(1) | | | | | |
| Basic earnings | \$ 1.36 | \$ 1.34 | \$ 1.35 | \$ 1.28 | \$ 1.19 |
| Diluted earnings | 1.34 | 1.32 | 1.31 | 1.24 | 1.16 |
| Cash dividends paid | 0.75 | 0.72 | 0.65 | 0.57 | 0.49 |
| Basic average common shares | | | | | |
| outstanding | 28,946,847 | 28,891,412 | 28,505,392 | 27,557,04 | 27,669,811 |
| Diluted average common shares | | | | | |
| outstanding | 29,353,128 | 29,490,216 | 29,465,613 | 28,505,43 | 28,507,220 |
| Average balance sheet | | | | | |
| Loans | \$2,014,420 | \$1,900,023 | \$1,625,419 | \$1,354,127 | \$1,333,300 |
| Investments | 925,635 | 903,063 | 941,910 | 950,225 | 823,004 |
| Other interest-earning assets | 79,670 | 51,740 | 41,064 | 28,782 | 25,411 |
| Total assets | 3,229,224 | 3,039,186 | 2,773,405 | 2,466,070 | 2,309,422 |
| Deposits | 2,469,514 | 2,259,831 | 2,094,998 | 1,927,899 | 1,808,390 |
| Borrowed funds | 434,938 | 456,599 | 372,141 | 270,325 | 247,221 |
| Shareholders' equity | 281,847 | 272,974 | 251,963 | 216,846 | 198,373 |
| Balance sheet at year-end | | | | | |
| Loans | \$2,047,355 | \$1,985,493 | \$1,845,802 | \$1,408,391 | \$1,333,292 |
| Investments | 911,889 | 901,208 | 943,563 | 924,874 | 971,467 |
| Other interest-earning assets | 62,975 | 37,455 | 56,291 | 38,551 | 41,910 |
| Total assets | 3,249,828 | 3,117,359 | 3,024,515 | 2,510,939 | 2,490,864 |
| Deposits | 2,516,855 | 2,365,457 | 2,212,563 | 1,979,081 | 1,979,822 |
| Borrowed funds | 389,495 | 439,168 | 488,182 | 255,056 | 253,906 |
| Shareholders' equity | 294,751 | 273,232 | 270,532 | 227,053 | 206,206 |
| Performance ratios | | | | | |
| Return on average assets | 1.22% | 1.28% | 1.39% | 1.43% | 1.43% |
| Return on average equity | 13.98 | 14.22 | 15.31 | 16.29 | 16.60 |
| Average equity to average | | | | | |
| assets | 8.73 | 8.98 | 9.08 | 8.79 | 8.59 |
| Dividend payout ratio | 55.26 | 53.41 | 48.16 | 44.06 | 40.94 |

(1) Adjusted for a five percent stock dividend effective 9/15/06, 9/15/05, 9/15/04 and 9/16/02 and a five-for-four stock split effective 9/15/03.

(2) The results of operations include the acquisition of Millennium Bank effective April 30, 2004.

(3) The results of operations include the acquisition of the Cornerstone Companies effective January 1, 2006 and the sale of the Bank's Honesdale branch effective November 10, 2006.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in its accompanying consolidated financial statements for Harleysville National Corporation (the Corporation), and its wholly owned subsidiaries—Harleysville National Bank (the Bank), HNC Financial Company and HNC Reinsurance Company. The Corporation's consolidated financial condition and results of operations consist almost entirely of the Bank's financial condition and results of operations. Current performance does not guarantee, and may not be indicative of, similar performance in the future. The information in Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Corporation's consolidated financial statements and the accompanying footnotes under Item 8 of this report on Form 10-K.

Critical Accounting Estimates

The accounting and reporting policies of the Corporation and its subsidiaries conform to accounting principles generally accepted in the United States and general practices with the financial services industry. The Corporation's significant accounting policies are described in Note 1 of the consolidated financial statements and are essential in understanding Management's Discussion and Analysis of Results of Operations and Financial Condition. In applying accounting policies and preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amount of assets and liabilities as of the dates of the balance sheets and revenues and expenditures for the periods presented. Therefore, actual results could differ significantly from those estimates. Judgments and assumptions required by management, which have, or could have a material impact on the Corporation's financial condition or results of operations are considered critical accounting estimates. The following is a summary of the policies the Corporation recognizes as involving critical accounting estimates: Allowance for Loan Loss, Goodwill and Other Intangible Asset Impairment, Stock-Based Compensation, Unrealized Gains and Losses on Debt Securities Available for Sale, and Deferred Taxes.

Allowance for Loan Losses: The Corporation maintains an allowance for loan losses at a level management believes is sufficient to absorb estimated probable credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires significant estimates by management. Consideration is given to a variety of factors in establishing these estimates including historical losses, current and anticipated economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, borrowers' perceived financial and management strengths, the adequacy of underlying collateral, the dependence on collateral, and the strength of the present value of future cash flows and other relevant factors. These factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required which may adversely affect the Corporation's results of operations in the future.

Goodwill and Other Intangible Asset Impairment: Goodwill and other intangible assets are reviewed for potential impairment on an annual basis, or more often if events or circumstances indicate that there may be impairment, in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." Goodwill is tested for impairment at the reporting unit level and an impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. The Corporation employs general industry practices in evaluating the fair value of its goodwill and other intangible assets. The Corporation calculates the fair value using a combination of the following valuations: deposit premiums based on market deals, current stock pricing tracking as a multiple of book value, discounted cash flow of earnings with a terminal value and market multiple of earnings. Management performed its annual review of goodwill at June 30, 2006 in accordance with SFAS No. 142 and determined there was no impairment of goodwill and identifiable intangible assets. No assurance can be given that future impairment tests will not result in a charge to earnings.

Stock-based Compensation: The Corporation adopted SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS 123(R)) on January 1, 2006 using the modified prospective application method of transition. SFAS 123(R) was issued by the FASB in December 2004, requiring all forms of share-based payments to employees, including employee stock options, be treated the same as other forms of compensation by recognizing the related cost in the income statement. The expense of the option is generally measured at fair value at the grant date with compensation expense recognized over the service period, which is usually the vesting period. Prior to January 1, 2006, the Corporation followed SFAS 123 and APB 25 with *pro forma* disclosures of net income and earnings per share, as if the fair value-based method of accounting defined in SFAS 123 had been applied. Effective January 1, 2006, the Corporation recognizes compensation expense for the portion of outstanding awards at January 1, 2006 for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS 123 for *pro forma* disclosures. For new grants awarded on or after January 1, 2006, the Corporation has chosen to continue the use of the Black-Scholes option-pricing model (as used under SFAS 123) to estimate the fair value of each option on the date of grant. The Corporation estimates the fair value of options under the Black-Scholes model which takes into consideration the exercise price and expected life of the options, the current price of the underlying stock and its expected volatility, the expected dividends on the stock and the current risk-free interest rate for the expected life of the option. The Corporation's estimate of the fair value of a stock option is based on expectations derived from historical experience and may not necessarily equate to its market value when fully vested. In accordance with SFAS 123(R), the Corporation estimates the number of options for which the requisite service is expected to be rendered as compared to accounting for forfeitures as they occur under SFAS 123. The Corporation recognizes compensation expense for new grants using the straight-line method which recognizes compensation expense for shares vesting evenly over the period of vesting. *Pro forma* disclosures under SFAS 123 have been based upon the accrual method which treats each vesting tranche as a separate award and amortizes expense evenly (prorated) from grant date to vest date for each tranche.

Unrealized Gains and Losses on Debt Securities Available for Sale: The Corporation receives estimated fair values of debt securities from independent valuation services and brokers. In developing these fair values, the valuation services and brokers use estimates of cash flows based on historical performance of similar instruments in similar rate environments. Debt securities available for sale are mostly comprised of mortgage-backed securities as well as tax-exempt municipal bonds and U.S. government agency securities.

Deferred Taxes: The Corporation recognizes deferred tax assets and liabilities for the future effects of temporary differences, net operating loss carryforwards, and tax credits. Deferred tax assets are subject to management's judgment based upon available evidence that future realizations are likely. If management determines that the Corporation may not be able to realize some or all of the net deferred tax asset in the future, a charge to income tax expense may be required to reduce the value of the net deferred tax asset to the expected realizable value.

The Corporation has not substantively changed its application of the foregoing policies, and there have been no material changes in assumptions or estimation techniques used as compared to prior periods.

Financial Overview

The Corporation achieved its 31st consecutive year of earnings growth and the 32nd consecutive year of dividend increases to shareholders during 2006. For the year ended December 31, 2006, diluted earnings per share were \$1.34 compared to \$1.32 for 2005 and basic earnings per share were \$1.36 for 2006 compared to \$1.34 in 2005. Net income in 2006 was \$39.4 million compared to \$38.8 million in 2005.

The year-to-date financial results include the favorable impact on operations from the acquisition of the Cornerstone Companies effective January 1, 2006 and the \$6.9 million after-tax gain on the sale of the Bank's Honesdale branch during the fourth quarter of 2006 partially offset by lower net interest income due to the continued margin compression during 2006. The results also reflect the issuance of 1,382,000 shares of the Corporation's common stock for a 5% stock dividend payable September 15, 2006. All share and per share information has been restated to reflect this stock dividend.

The Corporation's consolidated total assets were \$3.2 billion at December 31, 2006, an increase of 4.2% or \$132.5 million over \$3.1 billion in total assets reported at December 31, 2005. This increase was primarily attributable to loan growth of \$61.9 million and an increase in cash and investments of \$40.3 million. The growth in loans took place primarily in the commercial and industrial, commercial real estate and residential mortgage portfolios.

The return on average shareholders' equity was 13.98% in 2006 compared to 14.22% in 2005. The return on average assets was 1.22% in 2006 compared to 1.28% in 2005. The decrease in the annualized return on average shareholders' equity during 2006, was primarily due to the retention of earnings.

Net interest income on a tax-equivalent basis decreased \$4.3 million, or 4.6%, for the year ending December 31, 2006, over the prior year. The decrease in net interest income for the year was mainly attributed to higher deposit and borrowing costs offset in part by higher loan and investment rates. The net interest margin for 2006 was 2.95% compared to 3.27% for 2005. Due to market conditions, deposit rates have increased more quickly than the loan rates have increased. Growth in average earning assets for 2006 was 5.8%. During 2006, noninterest income rose \$15.5 million primarily attributed to wealth management income generated from the Cornerstone Companies acquisition in January 2006, the \$10.7 million pre-tax gain on the sale of the Honesdale branch partially offset by the loss on sales of investment securities of \$674,000 as compared to a gain of \$4.8 million during 2005. Noninterest expense increased \$8.4 million mainly due to higher salary and benefits expense of \$7.2 million related to the Cornerstone Companies acquisition, higher staffing levels resulting from growth and increased incentives.

The quality of the loan portfolio is a key focus of the Corporation. Nonperforming assets (including nonaccrual loans, net assets in foreclosure and loans 90 days or more past due) were .54% of total assets at December 31, 2006, compared to .27% at December 31, 2005. The higher level of nonperforming assets was mainly due to an increase in nonaccrual commercial mortgage loans for six borrowers totaling \$6.0 million and an increase in real estate loans delinquent 90 days or more of \$1.6 million.

Core deposits (total deposits less time deposits) increased 3.4%, or \$55.5 million, to \$1.7 billion at December 31, 2006 as compared to \$1.6 billion at December 31, 2005. Total deposits increased \$151.4 million, or 6.4%, for the same period, which was primarily attributable to the growth in public fund interest checking products and time deposits.

On November 10, 2006, the Bank completed the sale of its Honesdale branch located in Wayne County, Pennsylvania with deposits of \$74.2 million, as well as loans and other assets of \$22.5 million to First National Community Bank. In connection with the sale, the Bank paid net cash of \$42.5 million and recorded a gain in the fourth quarter of 2006, net of federal income taxes, of \$6.9 million or \$.24 per diluted share. The sale of this single Wayne County location will allow the Bank to focus on expanding within its core markets and also help to provide the resources required to support strategic initiatives.

Effective January 1, 2006, the Bank completed its acquisition of the Cornerstone Companies, registered investment advisors for high net worth, privately held business owners, wealthy families and institutional clients. Located in the Lehigh Valley, Pennsylvania, the firm specializes in providing sophisticated open architecture asset management platforms, business succession and estate planning services, life insurance sales and compensation and benefits consulting. The Cornerstone Companies had assets under management of approximately \$1.5 billion at the acquisition date and serve clients throughout Pennsylvania and other mid-Atlantic states.

The transaction was accounted for using the purchase method of accounting. The purchase price consisted of \$15.0 million in cash paid at closing and a contingent payment of up to \$7.0 million to be paid post-closing. The contingent payment is based upon the Cornerstone Companies meeting certain minimum operating results during a five-year earn-out period with a maximum payout of \$7.0 million over this period. For 2006, the minimum operating results were met resulting in an earn-out payment of \$1.0 million which was recorded as additional goodwill. At December 31, 2006, the remaining maximum payout is \$6.0 million through 2010.

On June 30, 2005, the Bank sold its former subsidiary, Cumberland Advisors, Inc., to David R. Kotok and Associates, Inc. in a stock sale. The sale price was \$2.0 million cash. Cumberland Advisors, based in Vineland, New Jersey, is a SEC registered investment advisor specializing in fixed income money management and equities. It was acquired by the Corporation on April 30, 2004 as part of its Millennium Bank acquisition. Based upon management's analysis of Cumberland Advisors' results of operations and assets in comparison to the Corporation's, management determined the impact of the sale of Cumberland Advisors is immaterial, and therefore the transaction is not presented as discontinued operations.

For a five-year summary of financial information, see Item 6, "Selected Financial Data," which is incorporated herein by reference.

For quarterly information for 2006 and 2005, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Fourth Quarter 2006 Results," and Table 16, "Selected Quarterly Financial Data," which are incorporated herein by reference.

Investment Securities

SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" requires that debt and equity securities classified as available for sale be reported at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. The net effect of unrealized gains or losses, caused by marking an available for sale portfolio to market, causes fluctuations in the level of shareholders' equity and equity-related financial ratios as market interest rates cause the fair value of fixed-rate securities to fluctuate.

Investment securities increased to \$911.9 million at December 31, 2006 from \$901.2 million at December 31, 2005. The investment securities available for sale increased \$11.4 million and the investment securities held to maturity decreased \$676,000. During 2006, \$110.8 million of securities available for sale were sold which generated a pre-tax loss of \$674,000. The securities sold consisted primarily of bullet and callable agency, tax-exempt municipal and mortgage-backed securities. In comparison, \$273.9 million of securities available for sale were sold in 2005 which generated a pretax gain of \$4.8 million.

The following table shows the carrying value of the Corporation's investment securities available for sale and held to maturity:

Table 1—Investment Portfolio

| | December 31, | | |
|--|------------------------|------------------|------------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Investment securities available for sale: | | | |
| Obligations of other U.S. government agencies and corporations | \$119,956 | \$157,396 | \$153,103 |
| Obligations of states and political subdivisions | 201,643 | 173,845 | 198,499 |
| Mortgage-backed securities | 476,107 | 467,568 | 454,730 |
| Other securities | 55,304 | 42,844 | 68,400 |
| Total investment securities available for sale | <u>\$853,010</u> | <u>\$841,653</u> | <u>\$874,732</u> |
| Investment securities held to maturity: | | | |
| Obligations of other U.S. government agencies and corporations | \$ 3,856 | \$ 3,843 | \$ 3,830 |
| Obligations of states and political subdivisions | 55,023 | 55,712 | 64,662 |
| Mortgage-backed securities | — | — | 339 |
| Total investment securities held to maturity | <u>\$ 58,879</u> | <u>\$ 59,555</u> | <u>\$ 68,831</u> |

The maturity analysis of investment securities including the weighted average yield for each category as of December 31, 2006 is as follows. Actual maturities may differ from contractual maturities because issuers and borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Table 2—Maturity and Tax-Equivalent Yield Analysis of Investment Securities

| | December 31, 2006 | | | | |
|---|--------------------------|--|--|-----------------------|------------|
| | Due in 1 year or less | Due after 1 year through 5 years | Due after 5 years through 10 years | Due after 10 years | Total |
| | (Dollars in thousands) | | | | |
| Investment securities available for sale: | | | | | |
| Obligations of other U.S. government agencies and corporations: | | | | | |
| Fair value..... | \$17,694 | \$ 49,616 | \$ 47,271 | \$ 5,375 | \$119,956 |
| Weighted average yield | 4.26% | 4.49% | 5.00% | 5.32% | 4.69% |
| Weighted average maturity | | | | | 4.6 years |
| Obligations of states and political subdivisions: | | | | | |
| Fair value..... | — | 83,499 | 71,547 | 46,597 | 201,643 |
| Weighted average yield(1)..... | —% | 6.05% | 6.03% | 5.99% | 6.03% |
| Weighted average maturity | | | | | 7.3 years |
| Mortgage-backed securities: | | | | | |
| Fair value..... | 4,656 | 330,584 | 121,881 | 18,986 | 476,107 |
| Weighted average yield | 4.39% | 4.80% | 5.20% | 5.65% | 4.93% |
| Weighted average maturity | | | | | 4.7 years |
| Other debt securities: | | | | | |
| Fair value..... | — | 10,912 | 2,329 | 9,910 | 23,151 |
| Weighted average yield | —% | 5.53% | 4.71% | 5.95% | 5.63% |
| Weighted average maturity | | | | | 14.8 years |
| Equity securities: | | | | | |
| Fair value..... | — | — | — | — | 32,153 |
| Weighted average yield | —% | —% | —% | —% | 4.58% |
| Total investment securities available for sale: | | | | | |
| Fair value | \$22,350 | \$474,611 | \$243,028 | \$80,868 | \$853,010 |
| Weighted average yield | 4.28% | 5.00% | 5.40% | 5.86% | 5.16% |
| Weighted average maturity | | | | | 5.6 years |
| Investment securities held to maturity: | | | | | |
| Obligations of other U.S. government agencies and corporations: | | | | | |
| Amortized cost | \$ — | \$ — | \$ — | \$ 3,856 | \$ 3,856 |
| Weighted average yield | —% | —% | —% | 5.45% | 5.45% |
| Weighted average maturity | | | | | 11.5 years |
| Obligations of states and political subdivisions: | | | | | |
| Amortized Cost..... | 2,843 | 43,117 | — | 9,063 | 55,023 |
| Weighted average yield(1)..... | 8.02% | 6.36% | —% | 5.93% | 6.38% |
| Weighted average maturity | | | | | 3.7 years |
| Total investment securities held to maturity: | | | | | |
| Amortized Cost | \$ 2,843 | \$ 43,117 | \$ — | \$12,919 | \$58,879 |
| Weighted average yield | 8.02% | 6.36% | —% | 5.79% | 6.32% |
| Weighted average maturity | | | | | 4.2 years |

(1) Weighted average yield on nontaxable investment securities is shown on a tax equivalent basis (tax rate of 35%).

Loans

Loans increased \$61.9 million, or 3.1% in 2006, primarily attributed to growth in commercial and industrial, commercial real estate and residential mortgage loans. The growth in commercial loans was mainly due to the emphasis on owner-operated businesses and real estate loans in its primary market. One of the Bank's strategic objectives is to increase its loan to deposit ratio by growing its loan portfolio at a faster pace than its deposits. The planned reduction in lease financing was due to run-off and sales. Loans increased \$140.0 million, or 7.6% in 2005, primarily attributed to growth in commercial real estate loans and home equity loans.

The following table shows the composition of the Bank's loans, net of deferred costs:

Table 3—Composition of Loan Portfolio

| | 2006 | | 2005 | | December 31, 2004 | | 2003 | | 2002 | |
|---------------------------|--------------------|------------------|--------------------|------------------|-------------------------------|------------------|--------------------|------------------|--------------------|------------------|
| | Amount | Percent of Loans | Amount | Percent of Loans | Amount (Dollars in thousands) | Percent of Loans | Amount | Percent of Loans | Amount | Percent of Loans |
| Real estate . . . | \$ 845,880 | 41% | \$ 791,358 | 40% | \$ 693,468 | 37% | \$ 498,135 | 35% | \$ 422,692 | 33% |
| Commercial and industrial | 507,899 | 25% | 479,238 | 24% | 473,514 | 26% | 385,554 | 27% | 376,406 | 27% |
| Consumer . . . | 685,988 | 34% | 697,373 | 35% | 645,718 | 35% | 463,492 | 34% | 446,953 | 33% |
| Lease financing . . | 7,588 | —% | 17,524 | 1% | 33,102 | 2% | 61,210 | 4% | 87,241 | 7% |
| Total | <u>\$2,047,355</u> | <u>100%</u> | <u>\$1,985,493</u> | <u>100%</u> | <u>\$1,845,802</u> | <u>100%</u> | <u>\$1,408,391</u> | <u>100%</u> | <u>\$1,333,292</u> | <u>100%</u> |

The following table details outstanding loans by type as of December 31, 2006, in terms of contractual maturity date:

Table 4—Selected Loan Maturity Data

| | December 31, 2006 | | | |
|--|------------------------|----------------------------------|-------------------|--------------------|
| | Due in 1 year or less | Due after 1 year through 5 years | Due after 5 years | Total |
| | (Dollars in thousands) | | | |
| Real estate | \$106,827 | \$370,669 | \$368,384 | \$ 845,880 |
| Commercial and industrial | 104,800 | 157,328 | 245,771 | 507,899 |
| Consumer | 227,619 | 187,288 | 271,081 | 685,988 |
| Lease financing | 7,588 | — | — | 7,588 |
| Total | <u>\$446,834</u> | <u>\$715,285</u> | <u>\$885,236</u> | <u>\$2,047,355</u> |
| Loans with variable or floating interest rates | \$287,142 | \$110,533 | \$361,187 | \$ 758,862 |
| Loans with fixed predetermined interest rates | 159,692 | 604,752 | 524,049 | 1,288,493 |
| Total | <u>\$446,834</u> | <u>\$715,285</u> | <u>\$885,236</u> | <u>\$2,047,355</u> |

The Bank had no concentration of loans to individual borrowers which exceeded 10% of total loans at December 31, 2006 and 2005. The Bank actively monitors the risk of loan concentration. The Bank had no foreign loans, and the impact of nonaccrual and delinquent loans on total interest income was not material.

Nonperforming Assets

Nonperforming assets include loans that are in nonaccrual status or 90 days or more past due and loans that are in the process of foreclosure. A loan is generally classified as nonaccrual when principal or interest has consistently been in default for a period of 90 days or more, when there has been deterioration in the financial condition of the borrower, or payment in full of principal or interest is not expected. Delinquent loans past due

90 days or more and still accruing interest are loans that are generally well-secured and expected to be restored to a current status in the near future.

Nonperforming assets (including nonaccrual loans, loans 90 days or more past due and net assets in foreclosure) were .54% of total assets at December 31, 2006, compared to 0.27% at December 31, 2005 and 0.20% at December 31, 2004. The ratio of nonperforming loans to total net loans was 0.87% at December 31, 2006, compared to 0.42% at December 31, 2005 and 0.31% at December 31, 2004.

Nonaccruing loans increased \$7.7 million to \$15.2 million at December 31, 2006, as compared to December 31, 2005. The higher level of nonaccruing loans was mainly due to an increase in nonaccrual commercial mortgage loans during 2006: three borrowers totaling \$2.8 million during the first quarter, one borrower for \$803,000 in the second quarter and two borrowers totaling \$2.4 million during the fourth quarter. Nonaccruing loans increased \$2.8 million to \$7.5 million at December 31, 2005, in comparison to December 31, 2004. The increase in nonaccruing loans was primarily due to commercial mortgage loans for one borrower totaling \$1.5 million and commercial business loans for four borrowers totaling \$1.1 million which were placed on nonaccrual of interest. The Bank's policy for interest income recognition on nonaccrual loans is to recognize income under the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to the Bank. The Bank will not recognize income if these factors do not exist. During 2006, interest accrued on nonaccruing loans and not recognized as interest income was \$788,000 and interest paid on nonaccruing loans of \$191,000 was recognized as interest income. During 2005, interest accrued on nonaccruing loans and not recognized as interest income was \$310,000 and interest paid on nonaccruing loans of \$250,000 was recognized as interest income.

Loans past due 90 days or more and still accruing interest are loans that are generally well secured and are in the process of collection. As of December 31, 2006, loans past due 90 days or more and still accruing interest were \$2.4 million, compared to \$846,000 at December 31, 2005 and \$981,000 at December 31, 2004. The higher level of loans past due 90 days or more at December 31, 2006 from December 31, 2005 was primarily in the real estate loan portfolio.

There were no net assets in foreclosure at December 31, 2006. The December 31, 2005 net assets in foreclosure balance of \$29,000, decreased \$341,000 from December 31, 2004. During 2005, transfers from loans to assets in foreclosure were \$288,000, disposals on foreclosed properties were \$466,000, and charge offs of \$123,000 were recorded. Efforts to liquidate assets acquired in foreclosure proceed as quickly as potential buyers can be located and legal constraints permit. Foreclosed assets are carried at the lower of cost (lesser of carrying value of the asset or fair value at date of acquisition) or estimated fair value.

The following table presents information concerning nonperforming assets. Nonperforming assets include loans that are in nonaccrual status or 90 days or more past due and loans that are in the process of foreclosure.

Table 5—Nonperforming Assets

| | December 31, | | | | |
|--|------------------------|---------|---------|---------|---------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| | (Dollars in thousands) | | | | |
| Nonaccrual loans | \$15,201 | \$7,493 | \$4,705 | \$3,343 | \$5,109 |
| Loans 90 days or more past due | 2,444 | 846 | 981 | 1,164 | 1,193 |
| Total nonperforming loans | 17,645 | 8,339 | 5,686 | 4,507 | 6,302 |
| Net assets in foreclosure | | 29 | 370 | 935 | 390 |
| Total nonperforming assets | \$17,645 | \$8,368 | \$6,056 | \$5,442 | \$6,692 |
| Allowance for loan losses to nonperforming loans | 119.9% | 238.2% | 324.6% | 371.7% | 272.8% |
| Nonperforming loans to total loans | 0.87% | 0.42% | 0.31% | 0.32% | 0.47% |
| Allowance for loan losses to total loans | 1.03% | 1.00% | 1.00% | 1.19% | 1.29% |
| Nonperforming assets to total assets | 0.54% | 0.27% | 0.20% | 0.22% | 0.27% |

Allowance for Loan Losses

The Corporation uses the reserve method of accounting for loan losses. The balance in the allowance for loan losses is determined based on management's review and evaluation of the loan portfolio in relation to past loss experience, the size and composition of the portfolio, current economic events and conditions, and other pertinent factors, including management's assumptions as to future delinquencies, recoveries and losses. Increases to the allowance for loan losses are made by charges to the provision for loan losses. Credit exposures deemed to be uncollectible are charged against the allowance for loan losses. Recoveries of previously charged-off amounts are credited to the allowance for loan losses.

While management considers the allowance for loan losses to be adequate based on information currently available, future additions to the allowance may be necessary due to changes in economic conditions or management's assumptions as to future delinquencies, recoveries and losses and management's intent with regard to the disposition of loans. In addition, the Office of the Comptroller of the Currency (the OCC), as an integral part of their examination process, periodically reviews the Corporation's allowance for loan losses. The OCC may require the Corporation to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

The Corporation's allowance for loan losses is the accumulation of various components that are calculated based on various independent methodologies. The components of the allowance for credit losses consist of both historical losses and estimates. Management bases its recognition and estimation of each allowance component on certain observable data that it believes is the most reflective of the underlying loan losses being estimated. The observable data and accompanying analysis is directionally consistent, based upon trends, with the resulting component amount for the allowance for loan losses. The Corporation's allowance for loan losses components includes the following: historical loss estimation by loan product type and by risk rating within each product type; payment (past due) status, industry concentrations, internal and external variables such as economic conditions, credit policy and underwriting changes and results of the loan review process. The Corporation's historical loss component is the most significant component of the allowance for loan losses, and all other allowance components are based on the inherent loss attributes that management believes exist within the total portfolio that are not captured in the historical loss component.

The historical loss components of the allowance represent the results of analysis of historical charge-offs and recoveries within pools of homogeneous loans, within each risk rating and broken down further by segment, within the portfolio. Criticized assets are further assessed based on trends, expressed as percentages, relative to delinquency, risk rating and non-accrual, by credit product.

The historical loss components of the allowance for commercial loans are based principally on current risk ratings, historical loss rates adjusted, by adjusting the risk window, to reflect current events and conditions, as well as analysis of other factors that may have affected the collectibility of loans. The Corporation analyzes all commercial loans that have been identified as having potential credit risk. The review is accomplished via Watchlist Memorandum, and is designed to determine whether such loans are individually impaired, with impairment measured by reference to the collateral coverage and/or debt service coverage. The historical loss component of the allowance for consumer loans is based principally on loan payment status, retail classification and historical loss rates, adjusted by altering the risk window, to reflect current events and conditions.

The industry concentration component is recognized as a possible factor in the estimation of loan losses. Two industries represent possible concentrations: commercial real estate and consumer loans relying on residential home equity. No specific loss-related observable data is recognized by management currently, therefore no specific factor is calculated in the reserve solely for the impact of these concentrations, although management continues to carefully consider relevant data for possible future sources of observable data.

The historic loss model includes a judgmental component (environmental factors) that reflects management's belief that there are additional inherent credit losses based on loss attributes not adequately captured in the lagging indicators. Furthermore, given that past-performance indicators may not adequately capture current risk levels, allowing for a real-time adjustment enhances the validity of the loss recognition process. There are many credit risk management reports that are synthesized by credit risk management staff to assess the direction of credit risk and its instant effect on losses. It is important to continue to use experiential data to confirm risk as measurable losses will continue to manifest themselves at higher than normal levels even after the economic cycle has begun an upward swing and lagging indicators begin to show improvement. The judgmental component is allocated to the specific segments of the portfolio based on the historic loss component.

The allowance for loan losses increased \$1.3 million, or 6.5%, to \$21.2 million at December 31, 2006 as compared to December 31, 2005. The increase in the allowance was primarily due to inherent risk related to loan growth and the increase in nonperforming loans of \$9.3 million. The allowance for loan losses increased \$1.4 million, or 7.6%, to \$19.9 million at December 31, 2005 as compared to December 31, 2004. The increase in the allowance was primarily due to loan growth and the increase in nonperforming loans of \$2.7 million.

A summary of the activity in the allowance for loan losses is as follows:

Table 6—Allowance for Loan Losses

| | December 31, | | | | |
|---|------------------------|-------------|-------------|-------------|-------------|
| | 2006 | 2005 | 2004 | 2003 | 2002 |
| | (Dollars in thousands) | | | | |
| Average loans | \$2,014,420 | \$1,900,023 | \$1,625,419 | \$1,354,127 | \$1,333,300 |
| Allowance, beginning of year | \$ 19,865 | \$ 18,455 | \$ 16,753 | \$ 17,190 | \$ 15,558 |
| Loans charged off: | | | | | |
| Commercial and industrial | 1,141 | 353 | 522 | 515 | 108 |
| Consumer | 1,481 | 2,123 | 1,921 | 2,173 | 2,589 |
| Real estate | 1,047 | 383 | 208 | 1,311 | 352 |
| Lease financing | 42 | 188 | 883 | 556 | 828 |
| Total loans charged off | 3,711 | 3,047 | 3,534 | 4,555 | 3,877 |
| Recoveries: | | | | | |
| Commercial and industrial | 55 | 66 | 58 | 33 | 105 |
| Consumer | 519 | 586 | 496 | 685 | 786 |
| Real estate | 138 | 326 | 307 | 80 | 163 |
| Lease financing | 88 | 78 | 143 | 120 | 85 |
| Total recoveries | 800 | 1,056 | 1,004 | 918 | 1,139 |
| Net loans charged off | 2,911 | 1,991 | 2,530 | 3,637 | 2,738 |
| Reserve from Millennium Bank acquisition | | | 1,677 | | |
| Provision for loan losses | 4,200 | 3,401 | 2,555 | 3,200 | 4,370 |
| Allowance, end of year | \$ 21,154 | \$ 19,865 | \$ 18,455 | \$ 16,753 | \$ 17,190 |
| Ratio of net charge offs to average loans outstanding | 0.14% | 0.10% | 0.16% | 0.27% | 0.21% |

The following table sets forth an allocation of the allowance for loan losses by category. The specific allocations in any particular category may be reallocated in the future to reflect then current conditions. Accordingly, management considers the entire allowance to be available to absorb losses in any category.

Table 7—Allocation of the Allowance for Loan Losses by Loan Type

| | 2006 | | 2005 | | 2004 | | 2003 | | 2002 | |
|---------------------------|------------------------|----------------------|-----------------|----------------------|-----------------|----------------------|-----------------|----------------------|-----------------|----------------------|
| | Amount | Percent of Allowance | Amount | Percent of Allowance | Amount | Percent of Allowance | Amount | Percent of Allowance | Amount | Percent of Allowance |
| | (Dollars in thousands) | | | | | | | | | |
| Real estate | \$ 7,918 | 38% | \$ 6,422 | 32% | \$ 4,923 | 27% | \$ 3,919 | 23% | \$ 2,980 | 17% |
| Commercial and industrial | 9,119 | 43% | 8,534 | 43% | 7,456 | 40% | 6,840 | 41% | 5,248 | 31% |
| Consumer | 4,041 | 19% | 4,596 | 23% | 5,515 | 30% | 4,990 | 30% | 7,392 | 43% |
| Lease financing | 76 | —% | 313 | 2% | 561 | 3% | 1,004 | 6% | 1,570 | 9% |
| Total | <u>\$21,154</u> | <u>100%</u> | <u>\$19,865</u> | <u>100%</u> | <u>\$18,455</u> | <u>100%</u> | <u>\$16,753</u> | <u>100%</u> | <u>\$17,190</u> | <u>100%</u> |

Deposits and Borrowings

Deposits and borrowings are the primary funding sources of the Corporation. Core deposits increased 3.4%, or \$55.5 million, to \$1.7 billion at December 31, 2006, up from \$1.6 billion at December 31, 2005. Total deposits increased 151.4 million, or 6.4% for the same period, which was primarily attributable to the growth in public fund interest checking products and time deposits. The Corporation has placed more emphasis on government banking to provide additional funding sources through relationships with municipalities and school districts resulting in both interest-bearing checking accounts and large time deposits.

Deposit Structure

The following table is a distribution of average balances and average rates paid on the deposit categories for the last three years:

Table 8—Average Deposits

| | 2006 | | 2005 | | 2004 | |
|----------------------------------|------------------------|--------------|--------------------|--------------|--------------------|--------------|
| | Amount | Rate | Amount | Rate | Amount | Rate |
| | (Dollars in thousands) | | | | | |
| Demand—noninterest-bearing | \$ 333,406 | —% | \$ 335,962 | —% | \$ 312,963 | —% |
| Demand—interest-bearing | 450,256 | 3.24% | 351,071 | 1.64% | 289,611 | 0.66% |
| Money market and savings | 836,940 | 2.91% | 889,332 | 1.86% | 824,123 | 0.96% |
| Time deposits | 848,912 | 4.29% | 683,466 | 3.56% | 668,301 | 3.13% |
| Total interest-bearing deposits: | <u>\$2,136,108</u> | <u>3.53%</u> | <u>\$1,923,869</u> | <u>2.42%</u> | <u>\$1,782,035</u> | <u>1.73%</u> |
| Total deposits | <u>\$2,469,514</u> | | <u>\$2,259,831</u> | | <u>\$2,094,998</u> | |

The maturity distribution of certificates of deposit of \$100,000 and over as of December 31, 2006 is as follows:

Table 9—Maturity Distribution of Certificates of Deposit \$100,000 and Over

| | (Dollars in thousands) |
|--|---------------------------|
| Three months or less | \$ 46,594 |
| Over three months to six months | 69,173 |
| Over six months to twelve months | 64,955 |
| Over twelve months | 121,321 |
| Total | <u>\$302,043</u> |

Borrowings

Borrowings decreased \$49.7 million to \$389.5 million at December 31, 2006 from \$439.2 million at December 31, 2005. The decrease was the result of reductions of \$58.0 million in long-term Federal Home Loan Bank (FHLB) borrowings offset in part by increases of \$8.3 million in short-term borrowings.

Borrowings decreased \$49.0 million to \$439.2 million at December 31, 2005 from \$488.2 million at December 31, 2004. The decrease was the result of reductions of \$99.8 million in short-term borrowings offset in part by increases of \$25.0 million in long-term Federal Home Loan Bank (FHLB) borrowings and \$25.8 in subordinated debt. Subordinated debt increased to \$51.5 million at December 31, 2005. The Corporation completed a private placement of \$25.0 million in aggregate principal amount of fixed/floating rate preferred securities (subordinated debt) through a newly formed Delaware trust affiliate HNC Statutory Trust III on September 28, 2005.

The Bank, pursuant to a designated cash management agreement, utilizes securities sold under agreements to repurchase as vehicles for customers' sweep and term investment products. Securitization under these cash management agreements are in U.S. Treasury Securities and obligations of states and political subdivisions securities. Securities sold under agreements to repurchase are generally overnight transactions. These securities are held in a third-party custodian's account, designated by the Bank under a written custodial agreement that explicitly recognizes the Bank's interest in the securities.

Table 10—Securities Sold under Agreements to Repurchase

| Securities sold under agreements to repurchase: | At or for the year ended December 31, | | |
|---|---------------------------------------|-----------|-----------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Balance at year-end | \$ 96,840 | \$ 88,118 | \$ 84,945 |
| Weighted average rate at year-end | 4.61% | 3.45% | 1.51% |
| Maximum month-end balance | \$100,944 | \$155,239 | \$199,493 |
| Average balance during the year | \$128,185 | \$102,722 | \$106,169 |
| Weighted average rate during the year | 4.37% | 2.64% | 0.93% |

Results of Operations

Net income is affected by five major elements: (1) net interest income, or the difference between interest income earned on loans and investments and interest expense paid on deposits and borrowed funds; (2) the provision for loan losses, or the amount added to the allowance for loan losses to provide reserves for inherent losses on loans; (3) noninterest income, which is made up primarily of certain fees, wealth management income and gains and losses from sales of securities or other transactions; (4) noninterest expense, which consists primarily of salaries, employee benefits and other operating expenses; and (5) income taxes. Each of these major elements is reviewed in more detail in the following discussion.

Net Interest Income

Net interest income on a tax equivalent basis in 2006 decreased \$4.3 million, or 4.6% to \$89.2 million, compared to 2005. The decrease in 2006 was mostly due to higher deposit rates, partially offset by higher loan rates and loan volume. As a result of market conditions, deposit rates have continued to increase more quickly than the loan rates have increased. Net interest income on a tax equivalent basis in 2005 increased \$962,000, or 1.0% to \$93.5 million in comparison to 2004. The increase in 2005 was mostly due to higher loan volume, partially offset by higher deposit rates.

The rate volume analysis in the following table, which is computed on a tax-equivalent basis (tax rate of 35%), analyzes changes in net interest income for the last three years by their volume and rate components. The change attributable to both volume and rate has been allocated proportionately.

Table 11—Analysis of Changes in Net Interest Income—Fully Taxable-Equivalent Basis

| | 2006 compared to 2005 | | | 2005 compared to 2004 | | |
|--|-----------------------|-------------------------|-------------------|-----------------------|-------------------------|-------------------|
| | Net Change | Due to Change in Volume | Rate | Net Change | Due to Change in Volume | Rate |
| (Dollars in thousands) | | | | | | |
| Increase (decrease) in interest income: | | | | | | |
| Investment securities(1) | \$ 5,611 | \$1,019 | \$ 4,592 | \$ (800) | \$ (1,705) | \$ 905 |
| Federal funds sold and deposits in banks | 2,416 | 1,134 | 1,282 | 1,113 | 166 | 947 |
| Loans(1)(2) | 18,843 | 7,244 | 11,599 | 22,629 | 16,600 | 6,029 |
| Total | 26,870 | 9,397 | 17,473 | 22,942 | 15,061 | 7,881 |
| Increase (decrease) in interest expense: | | | | | | |
| Savings and money market deposits | 16,587 | 874 | 15,713 | 12,448 | 1,237 | 11,211 |
| Time deposits | 12,130 | 6,567 | 5,563 | 3,428 | 483 | 2,945 |
| Borrowed funds | 2,433 | (881) | 3,314 | 6,104 | 2,994 | 3,110 |
| Total | 31,150 | 6,560 | 24,590 | 21,980 | 4,714 | 17,266 |
| Net increase (decrease) in interest income | <u>\$ (4,280)</u> | <u>\$2,837</u> | <u>\$ (7,117)</u> | <u>\$ 962</u> | <u>\$10,347</u> | <u>\$ (9,385)</u> |

- (1) The interest earned on nontaxable investment securities and loans is shown on a tax-equivalent basis using a tax rate of 35%.
- (2) Nonaccrual loans have been included in the appropriate average loan balance category, but interest on nonaccrual loans has not been included for purposes of determining interest income.

Interest income on a tax-equivalent basis in 2006 increased \$26.9 million, or 17.0% to \$185.0 million, in comparison to 2005. The increase was primarily due to higher average loans of \$114.4 million, or 6.0%, and a 59 basis point rise in the average rates earned on loans. The average yield on investments also increased 50 basis points. Interest expense increased \$31.2 million, to \$95.8 million during 2006 mostly attributed to higher deposit and borrowing rates. The average rate paid on deposits during 2006 of 3.53% was 111 basis points higher compared to 2005 primarily due to higher rates on money market accounts, interest checking accounts and time deposits accounts. These higher rates resulted from the continued increase in short-term rates during 2006. The average rate paid on borrowings for 2006 of 4.69% was 75 basis points higher than 2005 mainly due to an increase in short-term borrowing rates.

Interest income on a tax-equivalent basis in 2005 increased \$22.9 million, or 17.0% to \$158.1 million as compared to 2004. This increase was mainly due to an increase in average loans of \$274.6 million, or 16.9%, and a 35 basis point rise in the average rates earned on loans. Interest expense increased \$22.0 million, to \$64.6 million during 2005 mainly attributed to higher deposit and borrowing rates. The average rate paid on deposits during 2005 of 2.42% was 69 basis points higher compared to 2004 and the average rate paid on borrowings for 2005 of 3.94% was 75 basis points higher than 2004 primarily resulting from the increase in short-term rates during 2005.

Net Interest Margin

The 2006 net interest margin of 2.95% was lower than the net interest margins for 2005 and 2004 of 3.27% and 3.55%, respectively. The decline in the net interest margin during 2006 and 2005 is mainly attributable to higher deposit and borrowing costs offset in part by higher loan and investment rates. As a result of market conditions, deposit rates have continued to increase more quickly than the loan rates have increased.

During 2006, the Corporation continued to manage its balance sheet in an effort to position it during the current rising rate scenario. The Corporation continued to sell securities with lower fixed rates and longer average lives in a rising rate and inverted yield curve environment and purchased securities with higher yields and more stable cash flows. As a result, the balance sheet is better positioned to mitigate market risk.

The table below presents the major asset and liability categories on an average basis for the periods presented, along with interest income and expense, and key rates and yields:

Table 12—Average Balance Sheets and Interest Rates—Fully Taxable-Equivalent Basis

| | Year Ended December 31, | | | | | | | | |
|---|-------------------------|-----------|-------|--------------------|-----------|-------|--------------------|-----------|-------|
| | 2006 | | | 2005 | | | 2004 | | |
| | Average Balance | Interest | Rate | Average Balance | Interest | Rate | Average Balance | Interest | Rate |
| | (Dollars in thousands) | | | | | | | | |
| Assets | | | | | | | | | |
| Earning Assets: | | | | | | | | | |
| Investment securities: | | | | | | | | | |
| Taxable investments | \$ 672,648 | \$ 30,296 | 4.50% | \$ 648,630 | \$ 23,923 | 3.69% | \$ 702,183 | \$ 23,891 | 3.40% |
| Nontaxable investments(1) | 252,987 | 15,421 | 6.10 | 254,433 | 16,183 | 6.36 | 239,727 | 17,015 | 7.10 |
| Total investment securities | 925,635 | 45,717 | 4.94 | 903,063 | 40,106 | 4.44 | 941,910 | 40,906 | 4.34 |
| Federal funds sold and deposits in banks | 79,670 | 4,053 | 5.09 | 51,740 | 1,637 | 3.16 | 41,064 | 524 | 1.28 |
| Loans(1)(2) | 2,014,420 | 135,197 | 6.71 | 1,900,023 | 116,354 | 6.12 | 1,625,419 | 93,725 | 5.77 |
| Total earning assets | 3,019,725 | 184,967 | 6.13 | 2,854,826 | 158,097 | 5.54 | 2,608,393 | 135,155 | 5.18 |
| Noninterest-earning assets | 209,499 | | | 184,360 | | | 165,012 | | |
| Total assets | <u>\$3,229,224</u> | | | <u>\$3,039,186</u> | | | <u>\$2,773,405</u> | | |
| Liabilities and Shareholders' Equity | | | | | | | | | |
| Interest-bearing liabilities: | | | | | | | | | |
| Interest-bearing deposits: | | | | | | | | | |
| Savings and money market | \$1,287,196 | 38,906 | 3.02% | \$1,240,403 | 22,319 | 1.80% | \$1,113,734 | 9,871 | 0.89% |
| Time | 848,912 | 36,460 | 4.29 | 683,466 | 24,330 | 3.56 | 668,301 | 20,902 | 3.13 |
| Total interest-bearing deposits | 2,136,108 | 75,366 | 3.53 | 1,923,869 | 46,649 | 2.42 | 1,782,035 | 30,773 | 1.73 |
| Borrowed funds | 434,938 | 20,402 | 4.69 | 456,599 | 17,969 | 3.94 | 372,141 | 11,865 | 3.19 |
| Total interest-bearing liabilities | 2,571,046 | 95,768 | 3.72 | 2,380,468 | 64,618 | 2.71 | 2,154,176 | 42,638 | 1.98 |
| Noninterest-bearing liabilities: | | | | | | | | | |
| Demand deposits | 333,406 | | | 335,962 | | | 312,963 | | |
| Other liabilities | 42,925 | | | 49,782 | | | 54,303 | | |
| Total noninterest-bearing liabilities | 376,331 | | | 385,744 | | | 367,266 | | |
| Total liabilities | 2,947,377 | | | 2,766,212 | | | 2,521,442 | | |
| Shareholders' equity | 281,847 | | | 272,974 | | | 251,963 | | |
| Total liabilities and shareholders' equity | <u>\$3,229,224</u> | | | <u>\$3,039,186</u> | | | <u>\$2,773,405</u> | | |
| Net interest spread | | | 2.41 | | | 2.83 | | | 3.20 |
| Effect of noninterest-bearing sources | | | 0.54 | | | 0.44 | | | 0.35 |
| Net interest income/margin on earning assets | | \$ 89,199 | 2.95% | | \$ 93,479 | 3.27% | | \$ 92,517 | 3.55% |
| Less tax equivalent adjustment | | 6,026 | | | 6,358 | | | 7,426 | |
| Net interest income | | \$ 83,173 | | | \$ 87,121 | | | \$ 85,091 | |

(1) The interest earned on nontaxable investment securities and loans is shown on a tax-equivalent basis (tax rate of 35%).

(2) Nonaccrual loans have been included in the appropriate average loan balance category, but interest on nonaccrual loans has not been included for purposes of determining interest income.

Interest Rate Sensitivity Analysis

In the normal course of conducting business activities, the Corporation is exposed to market risk, principally interest rate risk, through the operations of its banking subsidiary. Interest rate risk arises from market driven fluctuations in interest rates that affect cash flows, income, expense and value of financial instruments.

The Corporation actively manages its interest rate sensitivity positions. The objectives of interest rate risk management are to control exposure of net interest income to risks associated with interest rate movements and to achieve consistent growth in net interest income. The Asset/Liability Committee, using policies and procedures approved by the Corporation's Board of Directors, is responsible for managing the rate sensitivity position. The Corporation manages interest rate sensitivity by changing the mix and repricing characteristics of its assets and liabilities through the management of its investment securities portfolio, its offering of loan and deposit terms and through borrowings from the Federal Home Loan Bank. The nature of the Corporation's current operations is such that it is not subject to foreign currency exchange or commodity price risk.

The Corporation only utilizes derivative instruments for asset/liability management. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations and payments are based. The notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Interest rate swaps are contracts in which a series of interest-rate flows (fixed and floating) are exchanged over a prescribed period. The notional amounts on which the interest payments are based are not exchanged.

At December 31, 2006, the Corporation had cash flow hedges in the form of interest rate swaps with a notional amount of \$45.0 million that have the effect of converting the rates on money market deposit accounts to a fixed-rate cost of funds. This strategy will cause the Corporation to recognize, in a rising rate environment, a larger interest rate spread than it otherwise would have without the swaps in effect. In addition, the Corporation had cash flow hedges with a notional amount of \$10.0 million that have the effect of converting variable debt to a fixed rate. For these swaps, the Corporation recognized net interest income of \$442,000 and \$69,000 for the years ended December 31, 2006 and 2005 and estimates that for 2007, \$429,000 will be recognized as an increase in net interest income. These swaps mature in 2008. During the first quarter of 2005, the Corporation terminated a cash flow hedge with a notional value of \$25.0 million. The gross loss related to the termination of this swap was \$310,000 which was amortized through October 2006 in accordance with SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities." For the years ended December 31, 2006 and 2005, the Corporation amortized into net interest income \$151,000 and \$159,000, respectively related to this swap. Periodically, the Corporation may enter into fair value hedges to limit the exposure to changes in the fair value of loan assets. The Corporation has entered into fair value hedges with a notional amount of \$4.8 million with \$7,000 of interest income recognized for the year ended December 31, 2006. These swaps mature in 2015 through 2016. At December 31, 2006, the Corporation had swap agreements with a positive fair value of \$545,000 and with a negative fair value of \$21,000. At December 31, 2005, the swaps had a positive fair value of \$623,000. There was no hedge ineffectiveness recognized during 2006, 2005 and 2004.

The Corporation uses three principal reports to measure interest rate risk: (1) asset/liability simulation reports; (2) gap analysis reports; and (3) net interest margin reports. The Corporation's interest rate sensitivity, as measured by the repricing of its interest sensitive assets and liabilities at December 31, 2006, is presented in the following table. The data in the table was based in part on assumptions that are regularly reviewed for accuracy. The table presents data at a single point in time and includes management assumptions estimating the prepayment rate and the interest rate environment prevailing at December 31, 2006. The table indicates a liability sensitive one-year cumulative gap position of 9.51% of total earning assets.

Table 13—Contractual Repricing Data of Interest Sensitive Assets and Liabilities

| | December 31, 2006 | | | | |
|--|------------------------|--------------------|------------------------------------|-------------------|--------------------|
| | 0 to 90 days | 91 to 365 days | After 1 year through 5 years | Over 5 years | Total |
| | (Dollars in thousands) | | | | |
| Earning assets | | | | | |
| Investment securities | \$120,754 | \$ 131,025 | \$ 373,803 | \$286,307 | \$ 911,889 |
| Federal funds sold and deposits in banks | 62,975 | — | — | — | 62,975 |
| Loans | 659,216 | 148,161 | 721,192 | 518,786 | 2,047,355 |
| Total earning assets | <u>\$842,945</u> | <u>\$ 279,186</u> | <u>\$1,094,995</u> | <u>\$805,093</u> | <u>\$3,022,219</u> |
| Interest-bearing liabilities | | | | | |
| Interest-bearing checking accounts | \$166,538 | \$ 189,526 | \$ 183,910 | \$ — | \$ 539,974 |
| Money market funds | 80,129 | 211,493 | 371,344 | — | 662,966 |
| Savings accounts | 6,669 | 20,005 | 106,696 | — | 133,370 |
| Time deposits | 137,249 | 448,220 | 266,545 | 558 | 852,572 |
| Borrowed funds | 169,566 | 40,000 | 119,774 | 60,155 | 389,495 |
| Total interest-bearing liabilities | <u>\$560,151</u> | <u>\$ 909,244</u> | <u>\$1,048,269</u> | <u>\$ 60,713</u> | <u>\$2,578,377</u> |
| Interest rate swaps | <u>\$ 59,750</u> | <u>\$ —</u> | <u>\$ (55,000)</u> | <u>\$ (4,750)</u> | <u>\$ —</u> |
| Incremental gap | <u>\$342,544</u> | <u>\$(630,058)</u> | <u>\$ (8,274)</u> | <u>\$739,630</u> | |
| Cumulative gap(1) | <u>\$342,544</u> | <u>\$(287,514)</u> | <u>\$ (295,788)</u> | <u>\$443,842</u> | |
| Cumulative gap as a percentage of earning assets | 11.33% | -9.51% | -9.79% | 14.69% | |

- (1) The information is based upon significant assumptions, including the following: loans and leases are repaid by contractual maturity and repricing; securities, except mortgage-backed securities, are repaid according to contractual maturity adjusted for call features; mortgage-backed security repricing is adjusted for estimated early paydowns; interest-bearing demand, regular savings, and money market savings deposits are estimated to exhibit some rate sensitivity based on management's analysis of deposit withdrawals; and time deposits are shown in the table based on contractual maturity.

Management also simulates possible economic conditions and interest rate scenarios in order to quantify the impact on net interest income. The effect that changing interest rates have on the Corporation's net interest income is simulated by increasing and decreasing interest rates. This simulation is known as rate shocking. The results of the December 31, 2006 net interest income rate shock simulations show that the Corporation is within guidelines set by the Corporation's Asset/Liability Policy when rates increase or decrease 100 or 200 basis points.

The following table forecasts changes in the Corporation's market value of equity under alternative interest rate environments as of December 31, 2006. The market value of equity is defined as the net present value of the Corporation's existing assets and liabilities. The Corporation is within guidelines set by the Corporation's Asset/Liability Policy for the percentage change in the market value of equity.

Table 14—Market Value of Equity

| | December 31, 2006 | | | Asset/Liability Approved Percent Change |
|-------------------|---------------------------|--|----------------------|--|
| | Market Value of Equity | Change in Market Value of Equity (Dollars in thousands) | Percentage Change | |
| +300 Basis Points | \$344,758 | \$(109,664) | -24.13% | +/-35% |
| +200 Basis Points | 384,408 | (70,014) | -15.41 | +/-25 |
| +100 Basis Points | 421,920 | (32,502) | -7.15 | +/-15 |
| Flat Rate | 454,422 | — | 0.00 | — |
| -100 Basis Points | 456,673 | 2,251 | .50 | +/-15 |
| -200 Basis Points | 448,942 | (5,480) | -1.21 | +/-25 |
| -300 Basis Points | 437,970 | (16,452) | -3.62 | +/-35 |

In the event the Corporation should experience a mismatch in its desired gap ranges or an excessive decline in its market value of equity resulting from changes in interest rates, it has a number of options that it could use to remedy the mismatch. The Corporation could restructure its investment portfolio through the sale or purchase of securities with more favorable repricing attributes. It could also emphasize growth in loan products with appropriate maturities or repricing attributes, or attract deposits or obtain borrowings with desired maturities.

Provision for Loan Losses

The provision for loan losses of \$4.2 million for 2006 reflected an increase of \$799,000 compared to the 2005 provision of \$3.4 million. The increase in the provision during 2006 was primarily due to inherent risk related to loan growth and the increase in non-performing loans of \$9.3 million. Total net loans charged off in 2006, 2005 and 2004 were \$2.9 million, \$2.0 million and \$2.5 million, respectively.

Noninterest Income

Noninterest income of \$45.4 million for the year ended December 31, 2006 reflects an increase of \$15.5 million from 2005. During the fourth quarter of 2006, the Bank recognized a pre-tax gain of \$10.7 million on the sale of its Honesdale branch. The sale of this single Wayne County location included \$74.2 million in deposits, as well as approximately \$22.5 million in loans and other assets, and resulted in a net cash payment of \$42.5 million. The acquisition of the Cornerstone Companies was the primary driver of increases in wealth management income of \$8.0 million for the year of 2006 over 2005, partially offset by the sale of Cumberland Advisors, which was divested in the second quarter of 2005. In addition, noninterest income for 2006 included the pre-tax gain of \$1.4 million on the sale of the Bank's \$15.3 million credit card portfolio during the second quarter as well as increases in fee revenue resulting from credit card operations. Losses on sales of investment securities for 2006 were \$674,000 as compared to gains of \$4.8 million for 2005. Noninterest income for 2005 included the gains of \$690,000 and \$287,000 on the sales of Harleysville National Bank's McAdoo branch and Cumberland Advisors, Inc., respectively, during the second quarter.

Noninterest income of \$30.0 million during 2005 increased \$1.8 million compared to 2004. This was mainly due to an increase of \$1.1 million in gains on sales of investment securities and gains of \$690,000 and \$287,000 on the sales of Harleysville National Bank's McAdoo branch and Cumberland Advisors, Inc., respectively, during the second quarter of 2005. The increase in net security gains in 2005 was primarily the result of sales of tax-exempt, trust preferred and equity securities to position the balance sheet in the interest rate environment. The sale of the Bank's McAdoo branch located in Schuylkill County, Pennsylvania included deposits of \$13.9 million as well as certain loans and other assets of \$5.8 million to The Legacy Bank. The sale of the Bank's former subsidiary, Cumberland Advisors, Inc. was a stock sale for \$2.0 million cash. It was acquired by the Corporation on April 30, 2004 as part of its Millennium Bank acquisition. Based upon management's analysis of Cumberland Advisors' results of operations and assets in comparison to the Corporation's, management determined the impact of the sale of Cumberland Advisors was immaterial, and therefore the transaction was not presented as discontinued operations.

Noninterest Expense

Noninterest expense of \$70.9 million for the year ended December 31, 2006 increased \$8.4 million in comparison to 2005. Salaries and benefits expense rose \$7.2 million during 2006 from the previous year, primarily related to the acquisition of the Cornerstone Companies, partially offset by the sale of Cumberland Advisors in the second quarter of 2005, higher staffing levels resulting from growth, increased incentives, non-recurring compensation and severance charges primarily related to the former Chief Executive Officer's contract, and compensation expense of \$440,000 resulting from recording the Corporation's stock option expense in conformance with FAS 123(R), "Stock Based Compensation." Occupancy expense increased \$494,000 for the year ended December 31, 2006, over 2005 mostly due to the Cornerstone Companies acquisition and a new branch opening. Other expense increased \$2.0 million during 2006 mainly as a result of the Cornerstone Companies acquisition including amortization of intangible assets of \$448,000 partially offset by decreased marketing expenses during 2006.

Noninterest expense of \$62.5 million during 2005 increased \$2.9 million compared to 2004. Salaries and benefits expense increased \$361,000 for the year of 2005 over 2004, primarily due to the acquisition of Millennium Bank, increased staffing levels resulting from growth and higher pension and healthcare costs partially offset by lower bonus expense. Occupancy expense increased \$619,000 in 2005 over 2004, mostly due to the Millennium acquisition and a new branch opening. Other expense increased \$2.3 million during 2005, mainly due to increased expenses for advertising and professional fees (Sarbanes-Oxley related) as well as lower loan origination expense deferrals related to decreased loan origination volume.

Income Taxes

The effective income tax rates for 2006, 2005 and 2004 were 26.3%, 24.2% and 24.6% were less than the applicable federal statutory rate of 35%. The Corporation's effective rates were lower than the statutory tax rate primarily as a result of tax-exempt income earned from state and municipal securities and loans and bank-owned life insurance, as well as for 2005, the non-taxable gain on the sale of Cumberland Advisors, Inc.

Capital

Capital formation is important to the Corporation's well being and future growth. Capital, at the end of 2006, was \$294.8 million, an increase of \$21.5 million over the end of 2005. The increase was primarily the result of the retention of the Corporation's earnings and issuances of stock for stock options including tax benefits partially offset by dividends paid to the shareholders. At December 31, 2005, capital was \$273.2 million, an increase of \$2.7 million over December 31, 2004. The increase was primarily the result of the retention of the Corporation's earnings partially offset by dividends paid to the shareholders, the Corporation's repurchase of its common stock and the accumulated other comprehensive loss. Management believes that the Corporation's current capital position and liquidity position are strong and that its capital position is adequate to support its operations. Management is not aware of any recommendation by any regulatory authority, which, if it were to be implemented, would have a material effect on the Corporation's capital.

Pursuant to the federal regulators' risk-based capital adequacy guidelines, the components of capital are called Tier 1 and Tier 2 capital. For the Corporation, Tier 1 capital is generally common stockholder's equity and retained earnings adjusted to exclude disallowed goodwill and identifiable intangibles as well as the inclusion of qualifying trust preferred securities. Tier 2 capital for the Corporation is the allowance for loan losses. The risk-based capital ratios are computed by dividing the components of capital by risk-adjusted assets. Risk-adjusted assets are determined by assigning credit risk-weighting factors from 0% to 100% to various categories of assets and off-balance sheet financial instruments. The minimum for the Tier 1 capital ratio is 4.0%, and the total capital ratio (Tier 1 plus Tier 2 capital divided by risk-adjusted assets) minimum is 8.0%. At December 31, 2006, the Corporation's Tier 1 risk-adjusted capital ratio was 11.75%, and the total risk-adjusted capital ratio was 12.58%, both well above regulatory requirements. The risk-based capital ratios of the Bank also exceeded regulatory requirements at the end of 2006. At December 31, 2005, the Corporation's Tier 1 risk-adjusted capital ratio was 12.17%, and the total risk-adjusted capital ratio was 12.98%. The lower risk-based capital ratios of the Corporation at December 31, 2006 compared to December 31, 2005 were mainly due to the decrease in Tier 1 capital from the additional disallowed goodwill and identifiable intangibles related to the acquisition of the Cornerstone Companies during January 2006.

To supplement the risk-based capital adequacy guidelines, the Federal Reserve Board (FRB) established a leverage ratio guideline. The leverage ratio consists of Tier 1 capital divided by quarterly average total assets, excluding goodwill and identifiable intangibles. The minimum leverage ratio guideline is 3% for banking organizations that do not anticipate significant growth and that have well-diversified risk, excellent asset quality, high liquidity, good earnings and, in general, are considered top-rated, strong banking organizations. Other banking organizations are expected to have ratios of at least 4% or 5%, depending upon their particular condition and growth plans. Higher leverage ratios could be required by the particular circumstances or risk profile of a given banking organization. The Corporation's leverage ratios were 9.36% and 9.69% at December 31, 2006 and 2005, respectively. The lower leverage ratio of the Corporation at December 31, 2006 was mainly due to an increase in average assets which included increases in average loans and average federal funds sold.

Under FDIC regulations, a "well capitalized" institution must have a leverage ratio of at least 5%, a Tier 1 risk-based capital ratio of at least 6% and a total risk-based capital ratio of at least 10% and not be subject to a capital directive order. To be considered "adequately capitalized", an institution must generally have a leverage ratio of at least 4%, a Tier 1 risk-based capital ratio of at least 4% and a total risk-based capital ratio of at least 8%. An institution is deemed to be "critically under capitalized" if it has a tangible equity ratio of 2% or less. As of December 31, 2006, the Bank is above the regulatory minimum guidelines and meets the criteria to be categorized as a "well capitalized" institution.

The cash dividends paid during 2006 of \$.75 per share was 4.2% higher than the cash dividends in 2005 of \$.72. The proportion of net income paid out in dividends for 2006 was 55.26%, compared to 53.41% for 2005. Activity in both the Corporation's dividend reinvestment and stock purchase plan did not have a material impact on capital during 2006.

Liquidity

Liquidity is a measure of the ability of the Corporation to meet its current cash needs and obligations on a timely basis. For a bank, liquidity provides the means to meet the day-to-day demands of deposit customers and the needs of borrowing customers. Generally, the Bank arranges its mix of cash, money market investments, investment securities and loans in order to match the volatility, seasonality, interest sensitivity and growth trends of its deposit funds. The Corporation's decisions with regard to liquidity are based on the projections of potential sources and uses of funds for the next 120 days under the Corporation's asset/liability model.

The resulting projections as of December 31, 2006, show the potential sources of funds exceeding the potential uses of funds. The accuracy of this prediction can be affected by limitations inherent in the model and by the occurrence of future events not anticipated when the projections were made. The Corporation has external sources of funds which can be drawn upon when funds are required. The primary source of external liquidity is an available line of credit with the FHLB of Pittsburgh. As of December 31, 2006, the Bank had borrowings outstanding with the FHLB of \$239.8 million, all of which were long-term and pledged investment securities with a carrying value for available for sale of \$564.6 million and held to maturity of \$52.8 million. At December 31, 2006, the Bank had unused lines of credit at the FHLB of \$181.7 million and unused federal funds lines of credit of \$195.0 million.

There are no known trends or any known demands, commitments, events or uncertainties that will result in, or that are reasonably likely to result in liquidity increasing or decreasing in any material way.

The following table sets forth contractual obligations and other commitments representing required and potential cash outflows as of December 31, 2006:

Table 15—Contractual Obligations and Other Commitments

| | December 31, 2006 | | | | |
|---|--------------------|--------------------|------------------------------------|--------------------------------------|------------------|
| | Total | One year or less | After one year through three years | After three years through five years | After five years |
| | | | (Dollars in thousands) | | |
| Minimum annual operating leases | \$ 30,351 | \$ 2,343 | \$ 4,357 | \$ 3,703 | \$ 19,948 |
| Remaining contractual maturities of time deposits | 852,572 | 585,203 | 169,015 | 98,259 | 95 |
| Long-term borrowings and subordinated debt | 291,298 | 55,000 | 85,750 | 44,000 | 106,548 |
| Unfunded home equity lines of credit(1) | 301,344 | 771 | 10,239 | 12,785 | 277,549 |
| Unfunded other loan lines of credit | 448,984 | 360,401 | 50,733 | 26,863 | 10,987 |
| Unfunded residential mortgages | 3,497 | 3,497 | — | — | — |
| Standby letters of credit | 25,960 | 23,250 | 1,109 | 38 | 1,563 |
| Total | <u>\$1,954,006</u> | <u>\$1,030,465</u> | <u>\$321,203</u> | <u>\$185,648</u> | <u>\$416,690</u> |

(1) Home equity lines of credit in the after five years category have no stated expiration.

The Bank also had commitments with customers to extend mortgage loans at a specified rate at December 31, 2006 and 2005 of \$2.3 million and \$1.8 million, respectively and commitments to sell mortgage loans at a specified rate at December 31, 2006 and 2005 of \$792,000 and \$1.1 million, respectively. The commitments are accounted for as a derivative and recorded at fair value. The Bank estimates the fair value of these commitments by comparing the secondary market price at the reporting date to the price specified in the contract to extend or sell the loan initiated at the time of the loan commitment. At December 31, 2006 and 2005, the fair values of the loan commitments were \$12,000 and \$320, respectively, which were recorded as other income.

During April 2006, the Bank sold its existing credit card portfolio of \$15.3 million. The sale agreement stipulates that any credit card accounts delinquent over 30 days, overlimit accounts and petitioned bankruptcies will be guaranteed by the Bank for a period of one year. Of the \$15.3 million in credit card receivables sold, \$529,000 was sold with full recourse which was the total potential recourse exposure at the time of the sale. During the second quarter of 2006, the Bank recorded a recourse liability of \$371,000 which was the entire recourse liability recorded. This estimate was based on our historic losses as experienced on similar credit card receivables. The Bank will be subject to the full recourse obligations for a period of one year. At December 31, 2006, the total potential recourse exposure had been reduced to \$195,000 with a current recourse liability of \$96,000.

During January 2006, the Bank completed its acquisition of the Cornerstone Companies. The purchase price consisted of \$15.0 million in cash paid at closing and a contingent payment of up to \$7.0 million to be paid post-closing. The contingent payment is based upon the Cornerstone Companies meeting certain minimum operating results during a five-year earn-out period with a maximum payout of \$7.0 million over this period. For 2006, the minimum operating results were met resulting in an earn-out payment of \$1.0 million which was recorded as additional goodwill. At December 31, 2006, the remaining maximum payout is \$6.0 million through 2010.

During December 2004 and January 2005, the Bank sold lease financing receivables of \$10.5 million. Of these leases, \$1.2 million were sold with full recourse and the remaining leases were sold subject to recourse with a maximum exposure of ten percent of the outstanding receivable. The total recourse exposure at the time of the sale of the leases was \$2.0 million. During the first quarter of 2005, the Bank recorded a recourse liability of \$216,000 which was the entire recourse liability recorded. This estimate was based on our historic losses as experienced on similar lease financing receivables. After the first anniversary of the sale agreement, and on a quarterly basis thereafter, upon written request by the Bank, the purchaser will review the portfolio performance and may reduce the total exposure to an amount equal to ten percent of the outstanding net book value. The Bank will be subject to the full and partial recourse obligations until all the lease financing receivables have been paid or otherwise been terminated and all equipment has been sold or disposed of. The final lease payment is due in 2010 with approximately 85% of the lease financing receivables estimated to be paid down by December 31, 2007. The outstanding balance of these sold leases at December 31, 2006 was \$3.0 million with a total recourse exposure of \$709,000 and a current recourse liability of \$64,000.

For information on known uncertainties, see Item 1, "Business."

Fourth Quarter 2006 Results (Unaudited)

Net income for the fourth quarter of 2006 was \$13.3 million, as compared to \$9.8 million for the fourth quarter of 2005. Diluted and basic earnings per share during the fourth quarter of 2006 were \$.45 and \$.46, respectively, compared with \$.34 for the fourth quarter of 2005.

Net interest income on a tax equivalent basis in the fourth quarter of 2006 decreased \$2.0 million, or 8.7%, from the same period in 2005. The decrease during 2006 was mainly attributable to higher deposit and borrowing costs offset in part by higher loan and investment rates. The net interest margin for the fourth quarter of 2006 was 2.75%, compared to 3.16% for the fourth quarter of 2005. Due to market conditions, deposit rates have increased at a faster rate than loan rates, resulting in a lower net interest margin. Average earning assets increased \$145.9 million, or 5.0%, during the fourth quarter of 2006 versus the comparable period in 2005. Average loans grew by \$72.8 million, or 3.7%, during the same period with average federal funds sold to correspondent banks increasing \$58.2 million. Average interest-bearing deposits were up \$211.3 million, or 10.5%, primarily as a result of growth in interest-bearing checking accounts and time deposits.

Noninterest income of \$18.2 million for the fourth quarter of 2006 reflects an increase of \$10.6 million from the comparable period in 2005. During the fourth quarter of 2006, the Bank recognized a pre-tax gain of \$10.7 million on the sale of its Honesdale branch. The sale of this single Wayne County location included \$74.2 million in deposits, as well as approximately \$22.5 million in loans and other assets. Wealth management income increased \$2.1 million during the fourth quarter of 2006 over the same period in 2005 mainly attributable to the acquisition of the Cornerstone Companies. Losses on sales of investment securities for the fourth quarter of 2006 were \$674,000 as compared to gains of \$1.7 million during the same period in 2005.

Noninterest expense of \$18.5 million for the fourth quarter of 2006 increased \$3.7 million from \$14.8 million in the fourth quarter of 2005. Salaries and benefits expense rose \$3.2 million during the fourth quarter of 2006 from the comparable period in 2005, primarily related to the acquisition of the Cornerstone Companies, higher staffing levels resulting from growth, increased incentives, and compensation expense of \$95,000 resulting from recording the Corporation's stock option expense in conformance with FAS 123(R), "Stock Based Compensation." Occupancy expense and other expense increased \$127,000 and \$402,000, respectively, during the fourth quarter of 2006 over the same period in 2005 mostly due to the Cornerstone Companies acquisition including amortization of intangible assets of \$112,000 in other expense.

The following is the summarized (unaudited) consolidated quarterly financial data of the Corporation which, in the opinion of management, reflects all adjustments, consisting only of normal recurring adjustments, necessary for fair presentation of the Corporation's results of operations:

Table 16—Selected Quarterly Financial Data (Unaudited)

| | Three Months Ended 2006 | | | | Three Months Ended 2005 | | | |
|--|--|----------|----------|----------|-------------------------|----------|----------|----------|
| | Dec. 31 | Sept. 30 | June 30 | March 31 | Dec. 31 | Sept. 30 | June 30 | March 31 |
| | (Dollars in thousands, except per share information) | | | | | | | |
| Interest income..... | \$46,661 | \$45,961 | \$44,223 | \$42,096 | \$41,008 | \$38,570 | \$36,889 | \$35,272 |
| Interest expense..... | 26,849 | 25,347 | 22,947 | 20,625 | 19,148 | 16,826 | 15,042 | 13,602 |
| Net interest income..... | 19,812 | 20,614 | 21,276 | 21,471 | 21,860 | 21,744 | 21,847 | 21,670 |
| Provision for loan losses..... | 1,200 | 900 | 900 | 1,200 | 1,351 | 650 | 650 | 750 |
| Net interest income after provision for loan losses..... | 18,612 | 19,714 | 20,376 | 20,271 | 20,509 | 21,094 | 21,197 | 20,920 |
| Noninterest income..... | 18,206 | 8,286 | 10,020 | 8,933 | 7,565 | 7,730 | 7,752 | 6,943 |
| Noninterest expense..... | 18,467 | 17,560 | 17,775 | 17,125 | 14,770 | 15,313 | 16,893 | 15,503 |
| Income before income tax expense..... | 18,351 | 10,440 | 12,621 | 12,079 | 13,304 | 13,511 | 12,056 | 12,360 |
| Income tax expense..... | 5,079 | 2,533 | 3,336 | 3,128 | 3,493 | 3,349 | 2,366 | 3,195 |
| Net income..... | \$13,272 | \$ 7,907 | \$ 9,285 | \$ 8,951 | \$ 9,811 | \$10,162 | \$ 9,690 | \$ 9,165 |
| Net income per share(1) | | | | | | | | |
| Basic..... | \$ 0.46 | \$ 0.27 | \$ 0.32 | \$ 0.31 | \$ 0.34 | \$ 0.35 | \$ 0.33 | \$ 0.32 |
| Diluted..... | \$ 0.45 | \$ 0.27 | \$ 0.32 | \$ 0.30 | \$ 0.34 | \$ 0.34 | \$ 0.33 | \$ 0.31 |

(1) Adjusted for a five percent stock dividend effective 9/15/06 and 9/15/05.

(2) The results of operations include the acquisition of the Cornerstone Companies effective January 1, 2006 and the sale of the Bank's Honesdale branch effective November 10, 2006.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

In the normal course of conducting business activities, the Corporation is exposed to market risk, principally interest risk, through the operations of its banking subsidiary. Interest rate risk arises from market driven fluctuations in interest rates that affect cash flows, income, expense and values of financial instruments. The Asset/Liability Committee, using policies and procedures approved by the Bank's Board of Directors, is responsible for managing the rate sensitivity position.

No material changes in market risk strategy occurred during the fourth quarter of 2006. The Corporation continues to experience a challenging interest rate environment which has impacted our interest rate sensitivity exposure. Information on quantitative and qualitative disclosures about market risk is incorporated by reference to the discussion contained in Item 7, under the caption "Interest Rate Sensitivity," and Table 13, "Contractual Repricing Data of Interest Sensitive Assets and Liabilities," and Table 14, "Market Value of Equity."

Item 8. Financial Statements and Supplementary Data

HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

| | December 31, | |
|---|------------------------|--------------------|
| | 2006 | 2005 |
| | (Dollars in thousands) | |
| Assets | | |
| Cash and due from banks | \$ 61,895 | \$ 57,756 |
| Federal funds sold and securities purchased under agreements to resell | 59,000 | 35,000 |
| Interest-bearing deposits in banks | 3,975 | 2,455 |
| Total cash and cash equivalents | 124,870 | 95,211 |
| Residential mortgage loans held for sale | 1,857 | 2,028 |
| Investment securities available for sale | 853,010 | 841,653 |
| Investment securities held to maturity (market value \$59,297 and \$59,753, respectively) | 58,879 | 59,555 |
| Loans and leases | 2,045,498 | 1,983,465 |
| Less: Allowance for loan losses | (21,154) | (19,865) |
| Net loans | 2,024,344 | 1,963,600 |
| Premises and equipment, net | 33,785 | 27,570 |
| Accrued interest receivable | 14,950 | 13,282 |
| Goodwill | 43,956 | 31,552 |
| Intangible assets, net | 7,282 | 4,031 |
| Bank-owned life insurance | 61,720 | 59,334 |
| Other assets | 25,175 | 19,543 |
| Total assets | <u>\$3,249,828</u> | <u>\$3,117,359</u> |
| Liabilities and Shareholders' Equity | | |
| Deposits | | |
| Noninterest-bearing | \$ 327,973 | \$ 363,440 |
| Interest-bearing: | | |
| Checking accounts | 539,974 | 387,374 |
| Money market accounts | 662,966 | 667,952 |
| Savings | 133,370 | 190,033 |
| Time deposits | 852,572 | 756,658 |
| Total deposits | 2,516,855 | 2,365,457 |
| Federal funds purchased and securities sold under agreements to repurchase | 96,840 | 88,118 |
| Other short-term borrowings | 1,357 | 1,752 |
| Long-term borrowings | 239,750 | 297,750 |
| Accrued interest payable | 31,358 | 28,276 |
| Subordinated debt | 51,548 | 51,548 |
| Other liabilities | 17,369 | 11,226 |
| Total liabilities | 2,955,077 | 2,844,127 |
| Shareholders' equity: | | |
| Series preferred stock, par value \$1 per share; authorized 8,000,000 shares, none issued | — | — |
| Common stock, par value \$1 per share; authorized 75,000,000 shares; issued 29,074,250 shares in 2006 and 27,500,407 shares in 2005 | 29,074 | 27,500 |
| Additional paid-in capital | 194,713 | 167,418 |
| Retained earnings | 79,339 | 88,285 |
| Accumulated other comprehensive loss | (6,103) | (8,618) |
| Treasury stock, at cost: 109,767 shares in 2006 and 64,700 shares in 2005 | (2,272) | (1,353) |
| Total shareholders' equity | 294,751 | 273,232 |
| Total liabilities and shareholders' equity | <u>\$3,249,828</u> | <u>\$3,117,359</u> |

See accompanying notes to consolidated financial statements.

HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

| | Year Ended December 31, | | |
|--|---|------------------|------------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands, except per share data) | | |
| Interest income | | | |
| Loans and leases, including fees | \$134,115 | \$115,333 | \$ 92,518 |
| Investment securities: | | | |
| Taxable | 30,296 | 23,923 | 23,891 |
| Exempt from federal taxes | 10,477 | 10,846 | 10,796 |
| Federal funds sold and securities purchased under agreements to resell | 3,838 | 1,451 | 489 |
| Deposits in banks | 215 | 186 | 35 |
| Total interest income | <u>178,941</u> | <u>151,739</u> | <u>127,729</u> |
| Interest expense | | | |
| Savings and money market deposits | 38,906 | 22,319 | 9,871 |
| Time deposits | 36,460 | 24,330 | 20,902 |
| Short-term borrowings | 5,202 | 3,972 | 1,381 |
| Long-term borrowings | 15,200 | 13,997 | 10,484 |
| Total interest expense | <u>95,768</u> | <u>64,618</u> | <u>42,638</u> |
| Net interest income | <u>83,173</u> | <u>87,121</u> | <u>85,091</u> |
| Provision for loan losses | 4,200 | 3,401 | 2,555 |
| Net interest income after provision for loan losses | <u>78,973</u> | <u>83,720</u> | <u>82,536</u> |
| Noninterest income | | | |
| Service charges | 8,002 | 8,202 | 7,807 |
| (Loss) gain on sales of investment securities, net | (674) | 4,794 | 3,689 |
| Gain on sale of branch | 10,650 | 690 | — |
| Gain on sale of credit card portfolio | 1,444 | — | — |
| Wealth management | 14,698 | 6,651 | 6,586 |
| Bank-owned life insurance | 2,386 | 2,234 | 2,406 |
| Other income | 8,939 | 7,419 | 7,670 |
| Total noninterest income | <u>45,445</u> | <u>29,990</u> | <u>28,158</u> |
| Net interest income after provision for loan losses and noninterest income | <u>124,418</u> | <u>113,710</u> | <u>110,694</u> |
| Noninterest expense | | | |
| Salaries, wages and employee benefits | 44,647 | 37,441 | 37,080 |
| Occupancy | 5,670 | 5,176 | 4,557 |
| Furniture and equipment | 3,664 | 4,231 | 4,863 |
| Marketing | 1,854 | 2,506 | 2,262 |
| Other expense | 15,092 | 13,125 | 10,799 |
| Total noninterest expense | <u>70,927</u> | <u>62,479</u> | <u>59,561</u> |
| Income before income tax expense | <u>53,491</u> | <u>51,231</u> | <u>51,133</u> |
| Income tax expense | 14,076 | 12,403 | 12,566 |
| Net income | <u>\$ 39,415</u> | <u>\$ 38,828</u> | <u>\$ 38,567</u> |
| Net income per share information: | | | |
| Basic | <u>\$ 1.36</u> | <u>\$ 1.34</u> | <u>\$ 1.35</u> |
| Diluted | <u>\$ 1.34</u> | <u>\$ 1.32</u> | <u>\$ 1.31</u> |
| Cash dividends per share | <u>\$ 0.75</u> | <u>\$ 0.72</u> | <u>\$ 0.65</u> |
| Weighted average number of common shares: | | | |
| Basic | 28,946,847 | 28,891,412 | 28,505,392 |
| Diluted | 29,353,128 | 29,490,216 | 29,465,613 |

See accompanying notes to consolidated financial statements.

HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

| | Common Stock Number of Shares | Treasury Stock Number of Shares | Common Stock Par Value | Additional Paid in Capital (Dollars and share information in thousands) | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Total | Comprehensive Income (Loss) |
|---|---|---|---------------------------------|--|----------------------|--|-------------------|------------------|--------------------------------|
| Balance January 1, 2004 | 24,668 | (823) | \$24,668 | \$ 98,646 | \$109,502 | \$ 8,098 | \$(13,861) | \$227,053 | |
| Issuance of stock for stock options, net of tax benefits | 411 | — | 411 | 4,832 | — | — | — | 5,243 | |
| Issuance of stock awards | — | — | — | 7 | — | — | — | 7 | |
| Stock dividend | 1,295 | (46) | 1,295 | 28,456 | (29,764) | — | — | (13) | |
| Net income | — | — | — | — | 38,567 | — | — | 38,567 | \$38,567 |
| Other comprehensive loss, net of reclassifications and tax | — | — | — | — | — | (6,855) | — | (6,855) | (6,855) |
| Issuance of common stock for acquisition of Millennium Bank | 946 | — | 946 | 27,974 | — | — | — | 28,920 | |
| Purchases of treasury stock | — | (190) | — | 399 | — | — | (4,214) | (3,815) | |
| Sale of treasury stock | — | 16 | — | (275) | — | — | 275 | — | |
| Cash dividends | — | — | — | — | (18,575) | — | — | (18,575) | |
| Comprehensive income | — | — | — | — | — | — | — | — | <u>\$31,712</u> |
| Balance December 31, 2004 | 27,320 | (1,043) | 27,320 | 160,039 | 99,730 | 1,243 | (17,800) | 270,532 | |
| Issuance of stock for stock options, net of tax benefits | 142 | 153 | 142 | 1,284 | — | — | 3,027 | 4,453 | |
| Issuance of stock awards | — | — | — | 5 | — | — | — | 5 | |
| Stock dividend | 38 | 1,272 | 38 | 6,090 | (29,535) | — | 23,392 | (15) | |
| Net income | — | — | — | — | 38,828 | — | — | 38,828 | \$38,828 |
| Other comprehensive loss, net of reclassifications and tax | — | — | — | — | — | (9,861) | — | (9,861) | (9,861) |
| Purchases of treasury stock | — | (446) | — | — | — | — | (9,972) | (9,972) | |
| Cash dividends | — | — | — | — | (20,738) | — | — | (20,738) | |
| Comprehensive income | — | — | — | — | — | — | — | — | <u>\$28,967</u> |
| Balance December 31, 2005 | 27,500 | (64) | \$27,500 | \$167,418 | \$ 88,285 | \$(8,618) | \$(1,353) | \$273,232 | |
| Issuance of stock for stock options, net of excess tax benefits | 192 | 220 | 192 | 1,662 | — | — | 4,583 | 6,437 | |
| Issuance of stock awards | — | — | — | 5 | — | — | — | 5 | |
| Stock-based compensation expense | — | — | — | 440 | — | — | — | 440 | |
| Stock dividend | 1,382 | — | 1,382 | 25,188 | (26,582) | — | — | (12) | |
| Net income | — | — | — | — | 39,415 | — | — | 39,415 | \$39,415 |
| Other comprehensive income, net of reclassifications and tax | — | — | — | — | — | 2,515 | — | 2,515 | 2,515 |
| Purchases of treasury stock | — | (265) | — | — | — | — | (5,502) | (5,502) | |
| Cash dividends | — | — | — | — | (21,779) | — | — | (21,779) | |
| Comprehensive income | — | — | — | — | — | — | — | — | <u>\$41,930</u> |
| Balance December 31, 2006 | <u>29,074</u> | <u>(109)</u> | <u>\$29,074</u> | <u>\$194,713</u> | <u>\$ 79,339</u> | <u>\$(6,103)</u> | <u>\$(2,272)</u> | <u>\$294,751</u> | |

See accompanying notes to consolidated financial statements.

HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year Ended December 31, | | |
|---|-------------------------|------------------|------------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Operating activities | | | |
| Net income | \$ 39,415 | \$ 38,828 | \$ 38,567 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Provision for loan losses | 4,200 | 3,401 | 2,555 |
| Depreciation and amortization | 4,483 | 3,909 | 4,178 |
| Net amortization of investment securities discounts/premiums | 3,327 | 5,890 | 6,011 |
| Deferred income expense (benefit) | 659 | (5,530) | (3,582) |
| Loss (gain) on sales of investment securities, net | 674 | (4,794) | (3,689) |
| Gain on sale of branch | (10,650) | (690) | — |
| Gain on sale of credit card portfolio | (1,444) | — | — |
| Gain on sale of bank subsidiary | — | (287) | — |
| Bank-owned life insurance income | (2,386) | (2,234) | (2,406) |
| Stock-based compensation expense | 440 | — | — |
| Net increase in accrued interest receivable | (1,725) | (1,205) | (985) |
| Net increase in accrued interest payable | 4,412 | 2,039 | 3,183 |
| Net (increase) decrease in other assets | (8,085) | 3,214 | (2,007) |
| Net increase (decrease) in other liabilities | 1,711 | (8,850) | 6,416 |
| Other, net | (89) | 86 | 7 |
| Net cash provided by operating activities | <u>34,942</u> | <u>33,777</u> | <u>48,248</u> |
| Investing activities | | | |
| Proceeds from sales of investment securities available for sale | 110,842 | 273,919 | 1,348,441 |
| Proceeds from maturity or calls of investment securities held to maturity | 617 | 9,243 | 5,040 |
| Proceeds from maturity or calls of investment securities available for sale | 158,146 | 196,161 | 260,892 |
| Purchases of investment securities held to maturity | — | — | (3,826) |
| Purchases of investment securities available for sale | (278,063) | (454,254) | (1,607,251) |
| Net increase in loans | (101,554) | (147,029) | (283,337) |
| Net cash paid due to acquisition, net of cash acquired | (14,525) | — | (18,439) |
| Net cash paid in sale of branch | (42,472) | (7,431) | — |
| Net proceeds from sale of credit card portfolio | 16,705 | — | — |
| Net cash received from sale of bank subsidiary | — | 1,931 | — |
| Purchases of premises and equipment | (10,783) | (4,783) | (5,244) |
| Proceeds from sales of premises and equipment | 857 | 35 | — |
| Purchase of bank-owned life insurance | — | (5,000) | — |
| Proceeds from sales of other real estate | 109 | 466 | 1,085 |
| Net cash used in investing activities | <u>(160,121)</u> | <u>(136,742)</u> | <u>(302,639)</u> |
| Financing activities | | | |
| Net increase in deposits | 225,554 | 166,472 | 82,234 |
| Increase (decrease) in federal funds purchased and securities sold under agreements to repurchase | 8,722 | (54,327) | 55,633 |
| (Decrease) increase in short-term borrowings | (395) | (45,461) | 42,198 |
| Advances of long-term borrowings | 10,000 | 25,000 | 83,000 |
| Repayments of long-term borrowings | (68,000) | — | — |
| Advances of subordinated debt | — | 25,774 | 20,619 |
| Cash dividends | (21,779) | (20,738) | (18,575) |
| Repurchase of common stock | (5,502) | (9,972) | (3,815) |
| Proceeds from the exercise of stock options | 5,302 | 4,453 | 5,243 |
| Excess tax benefits from stock-based compensation | 948 | — | — |
| Other, net | (12) | (15) | (13) |
| Net cash provided by financing activities | <u>154,838</u> | <u>91,186</u> | <u>266,524</u> |
| Net increase (decrease) in cash and cash equivalents | <u>29,659</u> | <u>(11,779)</u> | <u>12,133</u> |
| Cash and cash equivalents at beginning of year | <u>95,211</u> | <u>106,990</u> | <u>94,857</u> |
| Cash and cash equivalents at end of year | <u>\$124,870</u> | <u>\$ 95,211</u> | <u>\$106,990</u> |
| Cash paid during the year for: | | | |
| Interest | \$ 91,435 | \$ 62,860 | \$ 39,994 |
| Income taxes | \$ 17,088 | \$ 18,940 | \$ 10,718 |
| Supplemental disclosure of noncash investing and financing activities: | | | |
| Transfer of assets from loans to other real estate owned | \$ 128 | \$ 288 | \$ 586 |
| Transfer of investments available for sale to investments held to maturity | — | — | 50,009 |
| Acquisition of Millennium Bank, common stock issued | — | — | 28,920 |

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 1—Summary of Significant Accounting Policies

Harleysville National Corporation (the Corporation) through its subsidiary bank, Harleysville National Bank (the Bank), provides a full range of banking services including loans and deposits and investment management, and trust and investment advisory services to individual and corporate customers primarily located in eastern Pennsylvania. HNC Financial Company and HNC Reinsurance Company are wholly owned subsidiaries of the Corporation. HNC Financial Company's principal business function is to expand the investment opportunities of the Corporation. HNC Reinsurance Company functions as a reinsurer of consumer loan credit life and accident and health insurance.

The Corporation and the Bank are subject to regulations of certain state and federal agencies and, accordingly, these regulatory authorities periodically examine the Corporation and the Bank. As a consequence of the extensive regulation of commercial banking activities, the Corporation's and the Bank's businesses are susceptible to being affected by state and federal legislation and regulations.

A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows.

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the Corporation and its wholly owned subsidiaries, the Bank, HNC Financial Company, and HNC Reinsurance Company. The Cornerstone Companies' (subsidiaries of the Bank) results of operations are included in the Corporation's results beginning January 1, 2006 through December 31, 2006. All significant intercompany accounts and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to conform to current year presentation. The accounting and reporting policies of the Corporation and its subsidiaries conform with accounting principles generally accepted in the United States and general practices within the financial services industry.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities as of the dates of the balance sheets and revenues and expenditures for the periods presented. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash and due from banks, federal funds sold, securities purchased under agreements to resell and interest-bearing deposits in banks with an original maturity of generally three months or less.

Investment Securities

The Corporation accounts for securities under Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Debt securities, which management has the intent and ability to hold until maturity, are classified as held to maturity and reported at amortized cost, adjusted for amortization of premiums and accretion of discounts using the interest method over the life of the securities. Debt and equity securities expected to be held for an indefinite period of time are classified as available for sale and are stated at fair value with unrealized gains and losses excluded from earnings

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 1—Summary of Significant Accounting Policies (Continued)

and reported in other comprehensive income, net of income taxes. The Corporation receives estimated fair values of debt securities from independent valuation services and brokers. In developing these fair values, the valuation services and brokers use estimates of cash flows based on historical performance of similar instruments in similar rate environments.

Amortization of premiums and accretion of discounts for investment securities available for sale and held to maturity are included in interest income. Realized gains and losses on the sale of investment securities are recognized using the specific identification method and are included in the consolidated statements of income.

The Corporation follows Financial Accounting Standards Board (FASB) FSP FAS Nos. 115-1 and FAS 124-1 "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other than temporary, and on measuring such impairment loss. The Corporation uses various indicators in determining whether a security is other-than-temporarily impaired, including for equity securities, if the market value is below its cost for an extended period of time with low expectation of recovery or for debt securities, when it is probable that the contractual interest and principal will not be collected.

Loans

Loans that management intends to hold to maturity are stated at the principal amount outstanding. Net loans represent the principal loan amount outstanding net of deferred fees and costs, unearned income and the allowance for loan losses. Interest on loans is credited to income based on the principal amount outstanding.

Lease financing represents automobile and equipment leasing. The lease financing receivable included in loans is stated at the gross amount of lease payments receivable, plus the residual value, less income to be earned over the life of the leases. Income is recognized over the term of the leases using the level yield method.

Loan origination fees and direct loan origination costs of completed loans are deferred and recognized over the life of the loan as an adjustment to the yield. The net loan origination fees recognized as yield adjustments are reflected in loan interest income in the consolidated statements of income and the unamortized balance of the net loan origination fees is reported in loans outstanding in the consolidated balance sheets.

Income recognition of interest on loans is discontinued when, in the opinion of management, the collectibility of principal or interest becomes doubtful. A loan is generally classified as nonaccrual when principal or interest has consistently been in default for a period of 90 days or more or because of deterioration in the financial condition of the borrower, and payment in full of principal or interest is not expected. When a loan is placed on nonaccrual status, all accrued but uncollected interest is reversed from income. The Corporation recognizes income on nonaccrual loans under the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to the Corporation. The Corporation will not recognize income if these factors do not exist. Loans past due 90 days or more and still accruing interest are loans that are generally well-secured and expected to be restored to a current status in the near future.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 1—Summary of Significant Accounting Policies (Continued)

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. The Corporation accounts for impaired loans under SFAS No. 114, "Accounting by Creditors for Impairment of a Loan", as amended by SFAS No. 118, "Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures." Individually impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. Regardless of the measurement method, impairment is based on the fair value of the collateral when foreclosure is probable. If the recorded investment in impaired loans exceeds the measure of estimated fair value, a specific allowance is established as a component of the allowance for loan losses. The Corporation's policy for interest income recognition on impaired loans is to recognize income on restructured loans under the accrual method.

The Corporation follows FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 requires a guarantor entity, at the inception of a guarantee covered by the measurement provisions of the interpretation, to record a liability for the fair value of the obligation undertaken in issuing the guarantee.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level that management believes is sufficient to absorb estimated probable credit losses. The allowance for loan losses is based on estimated net realizable value unless it is probable that loans will be foreclosed, in which case the allowance for loan losses is based on the fair value of the collateral less selling costs. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires significant estimates by management. Consideration is given to a variety of factors in establishing these estimates including historical losses, current and anticipated economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan review, borrowers' perceived financial and management strengths, the adequacy of underlying collateral, the dependence on collateral, and the strength of the present value of future cash flows and other relevant factors. These factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required which may adversely affect the Corporation's results of operations in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgment of information available to them at the time of their examination.

Mortgage Servicing

The Corporation performs various servicing functions on mortgage loans owned by others. A fee, usually based on a percentage of the outstanding principal balance of the loan, is received for these services.

The Corporation accounts for its transfers and servicing financial assets in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The Corporation originates mortgages under a definitive plan to sell or securitize those loans and service the loans owned by the investor. The Corporation initially measures servicing assets retained in a sale or securitization of the assets being serviced at their allocated previous carrying amount based on relative fair values at the date of

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 1—Summary of Significant Accounting Policies (Continued)

the sale or securitization. Servicing assets purchased or assumed rather than undertaken in a sale or securitization of the financial assets being serviced, are measured initially at fair value. Servicing assets are amortized in proportion to and over the period of net servicing income.

The Corporation estimates the fair value of servicing rights based upon the present value of expected future cash flows associated with the servicing rights discounted at a current market rate using the same assumptions used by bidders of servicing portfolios. The loans are grouped into homogenous pools for analysis based upon the predominant risk characteristics including origination date, loan type, interest rate and term. Assumptions are developed that include estimates of servicing costs, loan defaults, prepayment speeds, discount rates, market conditions and other factors that impact the value of retained interests. If the carrying value of mortgage servicing rights for a pool exceeds the estimated fair value, an impairment loss is recognized through a charge to the valuation allowance with a corresponding adjustment to earnings.

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or estimated fair value. Gains and losses on sales of loans are also accounted for in accordance with SFAS No. 134, "Accounting for Mortgage Securities Retained after the Securitization of Mortgage Loans Held for Sale by a Mortgage Banking Enterprise." This statement requires that an entity engaged in mortgage banking activities classify the retained mortgage-backed security or other interest, which resulted from the securitizations of a mortgage loan held for sale, based upon its ability and intent to sell or hold these investments.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is recorded using the straight-line and accelerated depreciation methods over the estimated useful lives of the assets. Leasehold improvements are amortized over the remaining useful lives of the leases (including renewal options) or estimated useful lives, whichever is shorter.

Net Assets in Foreclosure

Net assets in foreclosure include foreclosed real estate which is carried at the lower of cost (lesser of carrying value of loan or fair value at date of acquisition) or estimated fair value of the collateral less selling costs. Any write-down, at or prior to the dates the real estate is considered foreclosed, is charged to the allowance for loan losses. Subsequent write-downs and expenses incurred in connection with holding such assets are recorded in other expenses. Any gain or loss upon the sale of real estate owned is charged to operations as incurred. Net assets in foreclosure also includes foreclosed leases which are carried at lower of cost (lesser of carrying value of loan or fair value at date of acquisition) or estimated fair value less selling costs.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquired entity over the fair value of the identifiable net assets acquired in accordance with the purchase method of accounting. Goodwill is not amortized but is reviewed for potential impairment on an annual basis, or more often if events or circumstances indicate that there may be impairment, in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." Goodwill is tested for impairment at the reporting unit level and an impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. Core deposit intangibles are a measure of the value of checking and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 1—Summary of Significant Accounting Policies (Continued)

savings deposits acquired in business combinations accounted for under the purchase method. Core deposit intangibles and other identified intangible assets with finite useful lives are amortized on a straight-line basis over their estimated lives (ranging from five to ten years) and are evaluated for impairment if events and circumstances indicate a possible impairment. The Corporation employs general industry practices in evaluating the fair value of its goodwill and other intangible assets. The Corporation calculates the fair value using a combination of the following valuations: deposit premiums based on market deals, current stock pricing tracking as a multiple of book value, discounted cash flow of earnings with a terminal value and market multiple of earnings. Any impairment loss related to goodwill and other intangible assets is reflected as other noninterest expense in the statement of operations in the period in which the impairment was determined. No assurance can be given that future impairment tests will not result in a charge to earnings. See Note 8 – Goodwill and Other Intangibles for additional information.

Derivatives

The Corporation accounts for derivatives in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" as amended. The statement requires the Corporation to recognize all derivative instruments at fair value as either assets or liabilities. The accounting for changes in the fair value of a derivative instrument depends on whether, at inception, it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as hedges, the gain or loss is recognized in current earnings. When the Corporation designates a derivative as hedging, it is required to establish at the inception of the hedge, the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the Corporation's approach to managing risk:

The Corporation enters into interest rate swap contracts to modify the interest rate characteristics from variable to fixed in order to reduce the impact of interest rate changes on future net interest income. Net amounts payable or receivable from these contracts are accrued as an adjustment to interest income or interest expense of the related asset or liability. Interest rate swap agreements are designated as either cash flow hedges or fair value hedges. For cashflow hedges, the fair value of these derivatives is reported in other assets or other liabilities and offset in accumulated other comprehensive income for the effective portion of the derivatives. Amounts reclassified into earnings, when the hedged transaction culminates, are included in net interest. Ineffectiveness of the strategy, as defined under SFAS No. 133, if any, is reported in net interest. In a fair value hedge, the fair values of the interest rate swap agreements and changes in the fair values of the hedged items are recorded in the Corporation's consolidated balance sheet with the corresponding gain or loss being recognized in current earnings. The difference between changes in the fair values of interest rate swap agreements and the hedged items represents hedge ineffectiveness and is recorded in net interest in the Corporation's income statement. The Corporation performs an assessment, both at the inception of the hedge and quarterly thereafter, to determine whether these derivatives are highly effective in offsetting changes in the value of the hedged items.

Stock-Based Compensation

The Corporation adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (SFAS 123(R)) on January 1, 2006 using the modified prospective application method of transition. Under SFAS 123(R), all forms of share-based payments to employees, including employee stock options, is treated the same as other forms of compensation by recognizing the related cost in the income statement. The expense of

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 1—Summary of Significant Accounting Policies (Continued)

the award is generally measured at fair value at the grant date with compensation expense recognized over the service period, which is usually the vesting period. Prior to January 1, 2006, the Corporation followed APB 25 and the disclosure requirements of SFAS 123(R) with *pro forma* disclosures of net income and earnings per share, as if the fair value-based method of accounting defined in SFAS 123 had been applied. The Corporation's consolidated financial statements as of December 31, 2006 and for the year of 2006 reflect the impact of adopting SFAS 123(R). In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). Effective January 1, 2006, the Corporation recognizes compensation expense for the portion of outstanding awards at January 1, 2006 for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS 123 for *pro forma* disclosures. For new grants awarded on or after January 1, 2006, the Corporation has chosen to continue the use of the Black-Scholes option-pricing model (as used under SFAS 123) to estimate the fair value of each option on the date of grant. In accordance with SFAS 123(R), commencing January 1, 2006, the Corporation estimates the number of options for which the requisite service is expected to be rendered as compared to accounting for forfeitures as they occur under SFAS 123. The Corporation recognizes compensation expense for new grants using the straight-line method which recognizes compensation expense for shares vesting evenly over the period of vesting. *Pro forma* disclosures under SFAS 123 have been based upon the accrual method which treats each vesting tranche as a separate award and amortizes expense evenly (prorated) from grant date to vest date for each tranche. The Corporation recognized share-based compensation expense, net of tax, during the year of 2006 of \$407,000. See Note 14 – Stock-Based Compensation for additional information.

Income Taxes

There are two components of income tax expense: current and deferred. Current income tax expense approximates cash to be paid or refunded for taxes for the applicable period. Deferred tax assets and liabilities are recognized due to differences between the basis of assets and liabilities as measured by tax laws and their basis as reported in the financial statements. Deferred tax assets are subject to management's judgment based upon available evidence that future realizations are likely. If management determines that the Corporation may not be able to realize some or all of the net deferred tax asset in the future, a charge to income tax expense may be required to reduce the value of the net deferred tax asset to the expected realizable value. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax expense or benefit is recognized for the change in deferred tax liabilities or assets between periods.

Pension Plans

The Corporation has certain employee benefit plans covering substantially all employees. The Corporation accrues service cost as incurred. The Corporation's current measurement date for plan assets and obligations is fiscal year-end. In accordance with the implementation of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" effective at the end of the fiscal year 2006, the Corporation recognizes for its defined benefit pension plan an asset for the overfunded status or a liability for the underfunded status in its statement of financial position and recognizes changes in the funded status of the plan in the year in which the changes occur. See Note 12 – Pension Plans for additional information.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 1—Summary of Significant Accounting Policies (Continued)

Bank-Owned Life Insurance

The Corporation invests in bank-owned life insurance (BOLI). BOLI involves the purchasing of life insurance by the Corporation on a chosen group of employees. The Corporation is the owner and beneficiary of the policies. This pool of insurance, due to tax advantages to the Bank, is profitable to the Corporation. This profitability is used to offset a portion of future benefit cost increases. The Bank's deposits fund BOLI and the earnings from BOLI are recognized as noninterest income.

In September 2006, the Emerging Issues Task Force (EITF) reached a final consensus on Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance." The consensus concludes that in determining the amount that could be realized under an insurance contract accounted for under FASB Technical Bulletin No. 85-4, the policyholder should (1) consider any additional amounts included in the contractual terms of the policy; (2) assume the surrender value on a individual-life by individual-life policy basis; and (3) not discount the cash surrender value component of the amount that could be realized when contractual restrictions on the ability to surrender a policy exist. Issue No. 06-05 is effective for fiscal years beginning after December 15, 2006. The Corporation does not expect the adoption of EITF Issue No. 06-5 will have any impact on the Corporation's financial position or results of operations.

Earnings Per Share

The Corporation follows the provisions of SFAS No. 128, "Earnings per Share." Basic earnings per share exclude dilution and are computed by dividing income available to common shareholders by the weighted-average common shares outstanding during the period. Diluted earnings per share take into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock. Proceeds assumed to have been received on such exercise or conversion are assumed to be used to purchase shares of the Corporation's common stock at the average market price during the period, as required by the "treasury stock method" of accounting. The effects of securities or other contracts to issue common stock are excluded from the computation of diluted earnings per share in periods in which the effect would be antidilutive. All weighted average shares, actual shares and per share information in the financial statements have been adjusted retroactively for the effect of stock dividends and splits.

Comprehensive Income

The Corporation records unrealized gains and losses on available for sale investment securities, net of tax and gains and losses on cash flow hedges, net of tax in other comprehensive income in shareholders' equity. Gains and losses on available for sale investment securities are reclassified to net income as the gains or losses are realized upon sale of the securities. Other-than-temporary impairment charges are reclassified to net income at the time of the charge. Gains or losses on derivatives are reclassified to net income as the hedged item affects earnings. In addition, in accordance with the implementation of SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" effective at the end of the fiscal year 2006, the Corporation recognized as a component of other accumulated comprehensive income, net of tax, the net loss and transition asset that had not been included in the net periodic benefit cost of its pension plan. Subsequently, the Corporation will recognize certain gains and losses and prior service costs or credits that arise during each reporting period, net of tax, as a component of other comprehensive income. Amounts recognized in accumulated other comprehensive income are adjusted as they are subsequently recognized in earnings as components of the plan's net periodic benefit cost. The Corporation follows the disclosure provisions of SFAS No. 130, "Reporting Comprehensive Income."

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 1—Summary of Significant Accounting Policies (Continued)

Variable Interest Entities

Harleysville Statutory Trust I (Trust I), HNC Statutory Trust II (Trust II) and HNC Statutory Trust III (Trust III) are considered variable interest entities under FASB Interpretation 46, "Consolidation of Variable Interest Entities," as revised (FIN 46R). Accordingly, Trust I, Trust II and Trust III are not consolidated in the Corporation's financial statements.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)." SFAS No. 158 requires an employer that is a business entity and sponsors one or more single-employer defined benefit plans to 1) recognize a plan's overfunded or underfunded status as an asset or liability in its financial statements, 2) measure plan assets and obligations as of fiscal year-end, and 3) recognize as a component of other comprehensive income, net of tax, the gains and losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost. The statement is effective for fiscal years ending after December 15, 2006 with the exception of the requirement to measure plan assets and obligations as of the employer's fiscal year-end which is effective for fiscal years ending after December 15, 2008. As a result of the application of the provisions of SFAS No. 158 as of December 31, 2006, shareholder's equity was reduced by approximately \$1.5 million after tax. See Note 12 – Pension Plans for additional information. The Corporation's current measurement date for plan assets and obligations is fiscal year-end. In December 2006, the federal bank regulatory agencies announced an interim decision that SFAS No. 158 will not affect bank organizations' regulatory capital and that any amounts recorded in accumulated other comprehensive income resulting from the adoption and application of SFAS No. 158 is excluded from regulatory capital.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 clarifies the definition of fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, although earlier application is encouraged. Prospective application of the provisions of SFAS No. 157 is required as of the beginning of the fiscal year in which it is initially applied, except for certain circumstances specified in the Statement that require retrospective application. The Corporation is in the process of assessing the impact of the adoption of this statement on the Corporation's financial statements.

In September 2006, the SEC issued SAB 108 to add section N, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" to Topic 1, Financial Statements, of the Staff Accounting Bulletin Series. Section N provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. These methods are referred to as the "roll-over" and "iron curtain" methods. The roll-over method quantifies the amount by which the current year income statement is misstated. Exclusive reliance on an income statement approach can result in the accumulation of errors on the balance sheet that may not have been material to any individual income statement, but which may misstate one or more balance sheet accounts. The iron curtain method quantifies the error as the cumulative amount by which the current year balance sheet is misstated.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 1—Summary of Significant Accounting Policies (Continued)

Exclusive reliance on a balance sheet approach can result in disregarding the effects of errors in the current year income statement that results from the correction of an error existing in previously issued financial statements. We currently use the roll-over method for quantifying identified financial statement misstatements. According to the guidance, a registrant must quantify the impact of correcting all misstatements on its current year financial statements, including both the carryover and reversing effects of prior year misstatements. Early application of the guidance in SAB No. 108 is encouraged in any report for an interim period of the first fiscal year ending after November 15, 2006, filed after the publication of this SAB. The adoption of SAB No. 108 did not have a material impact on the Corporation's financial statements.

In June, 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109." FIN No. 48 clarifies the accounting and reporting for income taxes where interpretation of the tax law may be uncertain. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 will apply to fiscal years beginning after December 15, 2006, with earlier adoption permitted. The Corporation does not anticipate that the adoption of FIN No. 48 will have a material impact on the Corporation's results of operations or financial condition.

In March 2006, the FASB issued SFAS No. 156, "Amending Accounting for Separately Recognized Servicing Assets and Servicing Liabilities," to simplify accounting for separately recognized servicing assets and servicing liabilities. SFAS No. 156 amends SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," to require an entity to 1) separately recognize financial assets as servicing assets or servicing liabilities, each time it undertakes an obligation to service a financial asset by entering into certain kinds of servicing contracts, 2) initially measure all separately recognized servicing assets and servicing liabilities at fair value, if practicable and 3) separately present servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. Additionally, SFAS No. 156 permits an entity to choose either the amortization method or the fair value measurement method for measuring each class of separately recognized servicing assets and servicing liabilities. SFAS 156 applies to all separately recognized servicing assets and liabilities acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006; although early adoption is permitted. The Corporation has chosen to continue to use the amortization method for measuring its mortgage servicing rights and does not expect the adoption of SFAS 156 to have a material impact on the Corporation's results of operations or financial condition.

Note 2—Acquisitions / Dispositions

On November 10, 2006, the Bank completed the sale of its Honesdale branch located in Wayne County, Pennsylvania with deposits of \$74.2 million, as well as loans and other assets of \$22.5 million to First National Community Bank. In connection with the sale, the Bank paid net cash of \$42.5 million and recorded a gain in the fourth quarter of 2006, net of federal income taxes, of \$6.9 million or \$.24 per diluted share. The sale of this single Wayne County location will allow the Bank to focus on expanding within its core markets and also help to provide the resources required to support strategic initiatives.

On April 14, 2006, the Bank sold its existing credit card portfolio to Elan Financial Services, a national credit card issuer and established an agent issuing relationship with Elan Financial Services. Under the agreement, credit cards for the Bank will be issued under the Harleysville National Bank name. The Bank sold \$15.3 million in credit card receivables resulting in a gain in the second quarter of 2006 from the sale of these

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 2—Acquisitions / Dispositions (Continued)

credit cards, net of federal income taxes, of \$939,000 or \$.03 per diluted share. The Bank continues to earn certain fees from ongoing portfolio activity. The sale agreement stipulates that any credit card accounts delinquent over 30 days, overlimit accounts and petitioned bankruptcies will be guaranteed by the Bank for a period of one year. Of the \$15.3 million in credit card receivables sold, \$529,000 was sold with full recourse which was the total potential recourse exposure at the time of the sale. During the second quarter of 2006, the Bank recorded a recourse liability of \$371,000 which was the entire recourse liability recorded. This estimate was based on our historic losses as experienced on similar credit card receivables. The Bank will be subject to the full recourse obligations for a period of one year. At December 31, 2006, the total potential recourse exposure had been reduced to \$195,000 with a current recourse liability of \$96,000.

Effective January 1, 2006, the Bank completed its acquisition of the Cornerstone Companies, registered investment advisors for high net worth, privately held business owners, wealthy families and institutional clients. Located in the Lehigh Valley, Pennsylvania, the firm specializes in providing sophisticated open architecture asset management platforms, business succession and estate planning services, life insurance sales and compensation and benefits consulting. The Cornerstone Companies had assets under management of approximately \$1.5 billion at the acquisition date and serve clients throughout Pennsylvania and other mid-Atlantic states.

The acquisition was consummated pursuant to the Purchase Agreement dated November 15, 2005, by and among the Bank and Cornerstone Financial Consultants, Ltd., a Pennsylvania corporation (CFC), Cornerstone Institutional Investors, Inc., a Pennsylvania corporation (CII), Cornerstone Advisors Asset Management, Inc., a Pennsylvania corporation (CAAM), and together with CFC and CII collectively, the Cornerstone Companies) and Cornerstone Management Resources, Inc., (CMR). Under the Purchase Agreement, the Bank acquired (i) all of the outstanding capital stock of CFC and CII, (ii) substantially all of the assets of CAAM, and (iii) certain limited assets of CMR. The purchase price consisted of \$15.0 million in cash paid at closing and a contingent payment of up to \$7.0 million to be paid post-closing. The contingent payment is based upon the Cornerstone Companies meeting certain minimum operating results during a five-year earn-out period with a maximum payout of \$7.0 million over this period. For 2006, the minimum operating results were met resulting in an earn-out payment of \$1.0 million which was recorded as additional goodwill. At December 31, 2006, the remaining maximum payout is \$6.0 million through 2010.

The Cornerstone Companies acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations." The Cornerstone Companies results of operations are included in the Corporation's results beginning January 1, 2006 through December 31, 2006. Goodwill and identifiable intangibles of \$12.4 million and \$3.9 million, respectively, were recorded in connection with the acquisition. The amortization of the identifiable intangibles totaled \$448,000 for the year ended December 31, 2006.

On June 30, 2005, the Bank sold its former subsidiary, Cumberland Advisors, Inc., to David R. Kotok and Associates, Inc. in a stock sale. The sale price was \$2.0 million cash and resulted in a non-taxable gain of \$287,000 recorded in the second quarter of 2005. Cumberland Advisors had assets of \$1.8 million. Cumberland Advisors, based in Vineland, New Jersey, is an SEC registered investment advisor specializing in fixed income money management and equities with approximately \$700 million in assets under management at June 30, 2005. It was acquired by the Corporation on April 30, 2004 as part of its Millennium Bank acquisition. Based upon management's analysis of Cumberland Advisors' results of operations and assets in comparison to the Corporation's, management determined the impact of the sale of Cumberland Advisors is immaterial, and therefore the transaction is not presented as discontinued operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 2—Acquisitions / Dispositions

On April 1, 2005, the Bank completed the sale of its McAdoo branch located in Schuylkill County, Pennsylvania with deposits of \$13.9 million as well as certain loans and other assets of \$5.8 million to The Legacy Bank. In connection with the sale, the Bank paid net cash of \$7.4 million and recorded a pre-tax profit of \$690,000 during the second quarter of 2005.

On April 30, 2004, the Corporation completed its acquisition of Millennium Bank which was merged with and into the Bank. Millennium Bank was based in Malvern, Pennsylvania with four banking offices, specializing in commercial lending and client relationship banking along with the wealth management unit, Cumberland Advisors, Inc. Millennium Bank's results of operations are included in the Corporation's results beginning April 30, 2004 through December 31, 2006.

The aggregate purchase price was \$52.8 million in cash and stock which included \$5.5 million in expenses associated with the acquisition. The Corporation acquired 100% of the outstanding shares of Millennium Bank. This transaction was accounted for using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations." Goodwill of \$32.5 million was recorded in connection with the acquisition of Millennium Bank.

Note 3—Restrictions on Cash and Due From Banks

As of December 31, 2006 and 2005, the Bank did not need to maintain reserves (in the form of deposits with the Federal Reserve Bank) to satisfy federal regulatory requirements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 4—Investment Securities

The amortized cost, unrealized gains and losses, and the estimated fair value of the Corporation's investment securities available for sale and held to maturity are as follows:

| | December 31, 2006 | | | |
|---|------------------------|------------------------------|-------------------------------|-------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| | (Dollars in thousands) | | | |
| Available for sale | | | | |
| Obligations of other U.S. government agencies and corporations | \$122,139 | \$ — | \$(2,183) | \$119,956 |
| Obligations of states and political subdivisions | 201,241 | 1,023 | (621) | 201,643 |
| Mortgage-backed securities | 481,126 | 388 | (5,407) | 476,107 |
| Other securities | 55,999 | 163 | (858) | 55,304 |
| Total investment securities available for sale | <u>\$860,505</u> | <u>\$1,574</u> | <u>\$(9,069)</u> | <u>\$853,010</u> |
| Held to maturity | | | | |
| Obligations of other U.S. government agencies and corporations | \$ 3,856 | \$ — | \$ (62) | \$ 3,794 |
| Obligations of states and political subdivisions | 55,023 | 584 | (104) | 55,503 |
| Total investment securities held to maturity | <u>\$ 58,879</u> | <u>\$ 584</u> | <u>\$ (166)</u> | <u>\$ 59,297</u> |

| | December 31, 2005 | | | |
|---|-------------------|--|---|-------------------------|
| | Amortized Cost | Gross Unrealized Gains (Dollars in thousands) | Gross Unrealized Losses (Dollars in thousands) | Estimated Fair Value |
| Available for sale | | | | |
| Obligations of other U.S. government agencies and corporations | \$161,371 | \$ 2 | \$ (3,977) | \$157,396 |
| Obligations of states and political subdivisions | 175,246 | 278 | (1,679) | 173,845 |
| Mortgage-backed securities | 475,261 | 245 | (7,938) | 467,568 |
| Other securities | 43,491 | 56 | (703) | 42,844 |
| Total investment securities available for sale | <u>\$855,369</u> | <u>\$ 581</u> | <u>\$(14,297)</u> | <u>\$841,653</u> |
| Held to maturity | | | | |
| Obligations of other U.S. government agencies and corporations | \$ 3,843 | \$ — | \$ (45) | \$ 3,798 |
| Obligations of states and political subdivisions | 55,712 | 615 | (372) | 55,955 |
| Total investment securities held to maturity | <u>\$ 59,555</u> | <u>\$ 615</u> | <u>\$ (417)</u> | <u>\$ 59,753</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 4—Investment Securities (Continued)

The tables below indicate the length of time individual securities have been in a continuous unrealized loss position at December 31, 2006 and 2005:

| Description of Securities | December 31, 2006 | | | | | | | | |
|--|---------------------|------------------|-------------------|---------------------|------------------|-------------------|-----------------|------------------|-------------------|
| | Less than 12 months | | | 12 months or longer | | | Total | | |
| | # of Securities | Fair Value | Unrealized Losses | # of Securities | Fair Value | Unrealized Losses | # of Securities | Fair Value | Unrealized Losses |
| (Dollars in thousands) | | | | | | | | | |
| Obligations of other U.S. government agencies and corporations | 1 | \$ 4,025 | \$ (34) | 44 | \$114,725 | \$(2,211) | 45 | \$118,750 | \$(2,245) |
| Obligations of states and political subdivisions | 66 | 33,542 | (137) | 102 | 49,930 | (588) | 168 | 83,472 | (725) |
| Mortgage-backed securities | 38 | 143,354 | (688) | 94 | 210,434 | (4,719) | 132 | 353,788 | (5,407) |
| Other securities | 8 | 11,452 | (122) | 6 | 19,421 | (736) | 14 | 30,873 | (858) |
| Totals | <u>113</u> | <u>\$192,373</u> | <u>\$(981)</u> | <u>246</u> | <u>\$394,510</u> | <u>\$(8,254)</u> | <u>359</u> | <u>\$586,883</u> | <u>\$(9,235)</u> |

| Description of Securities | December 31, 2005 | | | | | | | | |
|--|---------------------|------------------|-------------------|---------------------|------------------|-------------------|-----------------|------------------|-------------------|
| | Less than 12 months | | | 12 months or longer | | | Total | | |
| | # of Securities | Fair Value | Unrealized Losses | # of Securities | Fair Value | Unrealized Losses | # of Securities | Fair Value | Unrealized Losses |
| (Dollars in thousands) | | | | | | | | | |
| Obligations of other U.S. government agencies and corporations | 19 | \$ 52,713 | \$(1,232) | 37 | \$104,405 | \$(2,790) | 56 | \$157,118 | \$(4,022) |
| Obligations of states and political subdivisions | 252 | 120,860 | (1,407) | 48 | 22,460 | (644) | 300 | 143,320 | (2,051) |
| Mortgage-backed securities | 78 | 259,830 | (4,332) | 55 | 137,899 | (3,606) | 133 | 397,729 | (7,938) |
| Other securities | 6 | 5,271 | (148) | 3 | 12,417 | (555) | 9 | 17,688 | (703) |
| Totals | <u>355</u> | <u>\$438,674</u> | <u>\$(7,119)</u> | <u>143</u> | <u>\$277,181</u> | <u>\$(7,595)</u> | <u>498</u> | <u>\$715,855</u> | <u>\$(14,714)</u> |

The unrealized losses associated with these securities that management has the ability and intent to hold, are not considered to be other-than-temporary because the unrealized losses are related to changes in interest rates and do not affect the expected cash flows of the underlying collateral or issuer. There were 246 individual securities in a continuous unrealized loss position for twelve months or longer as of December 31, 2006.

Securities with a carrying value of \$617.4 million and \$568.2 million at December 31, 2006 and 2005, respectively, were pledged to secure public funds, customer trust funds, government deposits and repurchase agreements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 4—Investment Securities (Continued)

The amortized cost and estimated fair value of investment securities, at December 31, 2006, by contractual maturities are shown in the following table. Actual maturities will differ from contractual maturities because issuers and borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | December 31, 2006 | | | |
|--|-------------------|----------------------|--------------------|----------------------|
| | Held to Maturity | | Available for Sale | |
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| (Dollars in thousands) | | | | |
| Due in one year or less | \$ 2,843 | \$ 2,924 | \$ 17,787 | \$ 17,694 |
| Due after one year through five years | 43,117 | 43,513 | 144,650 | 144,027 |
| Due after five years through ten years | — | — | 122,272 | 121,147 |
| Due after ten years | 12,919 | 12,860 | 62,074 | 61,882 |
| | 58,879 | 59,297 | 346,783 | 344,750 |
| Mortgage-backed securities | — | — | 481,126 | 476,107 |
| Equity securities | — | — | 32,596 | 32,153 |
| Totals | <u>\$58,879</u> | <u>\$59,297</u> | <u>\$860,505</u> | <u>\$853,010</u> |

The components of net realized gains on sales of investment securities were as follows:

| | Year Ended December 31, | | |
|--|-------------------------|----------------|----------------|
| | 2006 | 2005 | 2004 |
| (Dollars in thousands) | | | |
| Gross realized gains | \$ 445 | \$5,812 | \$7,642 |
| Gross realized losses | (1,119) | (1,018) | (3,953) |
| Net realized (loss) gain on sales of investment securities | <u>\$ (674)</u> | <u>\$4,794</u> | <u>\$3,689</u> |

Note 5—Loans

Major classifications of loans are as follows:

| | December 31, | |
|--|--------------------|--------------------|
| | 2006 | 2005 |
| (Dollars in thousands) | | |
| Real estate (including loans held for sale of \$1,857 and \$2,028) | \$ 846,510 | \$ 792,345 |
| Commercial and industrial | 506,149 | 477,664 |
| Consumer loans | 682,307 | 694,251 |
| Lease financing | 7,588 | 17,524 |
| Total loans | 2,042,554 | 1,981,784 |
| Deferred costs, net | 4,801 | 3,709 |
| Allowance for loan losses | (21,154) | (19,865) |
| Net loans (including loans held for sale) | <u>\$2,026,201</u> | <u>\$1,965,628</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 5—Loans (Continued)

On December 31, 2006, nonaccrual loans were \$15.2 million and loans 90 days or more past due and still accruing interest were \$2.4 million. On December 31, 2005, nonaccrual loans were \$7.5 million and loans 90 days or more past due and still accruing interest were \$846,000. The Bank's policy for interest income recognition on nonaccrual loans is to recognize income under the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to the Bank. The Bank will not recognize income if these factors do not exist. During 2006, interest accrued on nonaccruing loans and not recognized as interest income was \$788,000 and interest paid on nonaccruing loans of \$191,000 was recognized as interest income. During 2005, interest accrued on nonaccruing loans and not recognized as interest income was \$310,000, and interest paid on nonaccruing loans of \$250,000 was recognized as interest income. During 2004, interest accrued on nonaccruing loans and not recognized as interest income was \$238,000, and interest paid on nonaccruing loans of \$47,000 was recognized as interest income.

The balance of impaired loans was \$3.9 million at December 31, 2006 compared to \$3.3 million at December 31, 2005. At December 31, 2006 and 2005, impaired loans with specific loss allowances were \$3.9 million and \$3.3 million and the related allowance for loan losses were \$678,000 and \$675,000, respectively. The average impaired loan balance was \$3.2 million in 2006, compared to \$1.5 million and \$1.8 million in 2005 and 2004, respectively. The income recognized on impaired loans during 2006, 2005 and 2004 was \$60,000, \$33,000 and \$2,000, respectively.

The Bank has no concentration of loans to individual borrowers which exceeded 10% of total loans at December 31, 2006 and 2005. The Bank actively monitors the risk of loan concentration.

The Bank continued to pursue new lending opportunities while seeking to maintain a portfolio that is diverse as to industry concentration, type and geographic distribution. The Bank's geographic lending area is primarily concentrated in Montgomery, Bucks, Carbon, Chester and Berks counties, but also includes Lehigh, Monroe and Northampton counties.

At December 31, 2006 and 2005, loans serviced for others (residential mortgage loans) totaled approximately \$330.6 million and \$328.3 million, respectively.

Loans to directors, executive officers and their associates are made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Activity of these loans is as follows:

| | Year Ended December 31, | | |
|---------------------------------------|-------------------------|-----------------|-----------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Balance, January 1 | \$22,099 | \$22,863 | \$21,038 |
| New loans | 66,666 | 75,230 | 70,711 |
| Repayments and other reductions | (71,372) | (75,994) | (68,886) |
| Balance, December 31 | <u>\$17,393</u> | <u>\$22,099</u> | <u>\$22,863</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 6—Allowance for Loan Losses

The table below summarizes the changes in the allowance for loan losses:

| | Year Ended December 31, | | |
|--|-------------------------|-----------------|-----------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Balance, beginning of year | \$19,865 | \$18,455 | \$16,753 |
| Provision for loan losses | 4,200 | 3,401 | 2,555 |
| Reserve from Millennium Bank acquisition | — | — | 1,677 |
| Loans charged off | (3,711) | (3,047) | (3,534) |
| Recoveries | 800 | 1,056 | 1,004 |
| Balance, end of year | <u>\$21,154</u> | <u>\$19,865</u> | <u>\$18,455</u> |

Note 7—Premises and Equipment

Premises and equipment consist of the following:

| | Estimated Useful Lives | December 31, | |
|--|------------------------|------------------------|------------------|
| | | 2006 | 2005 |
| | | (Dollars in thousands) | |
| Land | Indefinite | \$ 4,446 | \$ 4,797 |
| Buildings | 15-39 years | 31,963 | 26,503 |
| Furniture, fixtures and equipment | 3-7 years | 35,958 | 32,853 |
| Total cost | | 72,367 | 64,153 |
| Less accumulated depreciation and amortization | | (38,582) | (36,583) |
| Premises and equipment, net | | <u>\$ 33,785</u> | <u>\$ 27,570</u> |

Depreciation expense for the years ended December 31, 2006, 2005, and 2004 was \$3.3 million, \$3.4 million and \$3.4 million, respectively.

Note 8—Goodwill and Other Intangibles

Goodwill and identifiable intangibles were \$44.0 million and \$4.7 million, respectively at December 31, 2006, and \$31.6 million and \$1.4 million, respectively at December 31, 2005. Effective January 1, 2006, the Corporation completed the acquisition of the Cornerstone Companies. Goodwill of \$12.4 million (including a \$1.0 million earn-out payment for meeting minimum operating results during 2006) and customer relationship intangibles of \$3.9 million (with a weighted average amortization period of nine years) were recorded and allocated to the Wealth Management segment related to the acquisition. At December 31, 2006, the remaining maximum earn-out payout is \$6.0 million through 2010. The remaining goodwill balance relates to the acquisition of Millennium Bank (including Cumberland Advisors, Inc.) during 2004 in which \$32.5 million of goodwill was recorded and allocated to the Community Banking segment. During 2005, the Corporation sold Cumberland Advisors, Inc. including the write-off of \$996,000 of goodwill.

Management performed its annual review of goodwill at June 30, 2006 in accordance with SFAS No. 142 and determined there was no impairment of goodwill and other identifiable intangible assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 8—Goodwill and Other Intangibles (Continued)

The gross carrying value and accumulated amortization related to core deposit intangibles and other identifiable intangibles at December 31, 2006 and 2005 are presented below:

| | December 31, | | | |
|-------------------------------------|-----------------------------|---|-----------------------------|-----------------------------|
| | 2006 | | 2005 | |
| | Gross Carrying Amount | Accumulated Amortization (Dollars in thousands) | Gross Carrying Amount | Accumulated Amortization |
| Core deposit intangibles..... | \$1,929 | \$ 733 | \$1,929 | \$487 |
| Other identifiable intangibles..... | 3,913 | 448 | — | — |
| Total | <u>\$5,842</u> | <u>\$1,181</u> | <u>\$1,929</u> | <u>\$487</u> |

The remaining weighted average amortization period of core deposit and other identifiable intangibles was approximately eight years. The amortization of core deposit intangibles allocated to the Community Banking segment were \$246,000, \$246,000 and \$171,000 for the years ended December 31, 2006, 2005 and 2004, respectively. Amortization of identifiable intangibles related to the Wealth Management segment totaled \$448,000 for the year ended December 31, 2006. The Corporation estimates that aggregate amortization expense for core deposit and other identifiable intangibles will be \$679,000, \$671,000, \$671,000, \$671,000 and \$558,000 for 2007, 2008, 2009, 2010 and 2011, respectively.

Mortgage servicing rights of \$2.6 million at December 31, 2006 and 2005 are included on the Corporation's balance sheet in other intangible assets.

Note 9—Deposits

Time deposits with balances of \$100,000 or more were \$302.0 million and \$218.1 million at December 31, 2006 and 2005, respectively.

At December 31, 2006, scheduled maturities of certificates of deposit are as follows:

| | Amount (Dollars in thousands) |
|------------------|----------------------------------|
| 2007..... | \$585,203 |
| 2008..... | 100,680 |
| 2009..... | 68,335 |
| 2010..... | 73,750 |
| 2011..... | 24,509 |
| Thereafter | 95 |
| Total | <u>\$852,572</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 10—Borrowings

Federal Funds Lines of Credit with Correspondent Banks

Total federal funds lines of credit with correspondent banks at December 31, 2006 were \$195.0 million all of which is unused. These lines of credit are available for overnight funds and the rate is based on the correspondent bank's quoted rate at the time of the transaction.

Federal Home Loan Bank Advances

Federal Home Loan Bank (FHLB) advances at December 31, 2006 totaled \$239.8 million, all of which were long-term with a weighted average interest rate of 4.32%. FHLB advances at December 31, 2005 totaled \$297.8 million, all of which were long-term with a weighted average interest rate of 4.25%. The advances are collateralized by FHLB stock and certain first mortgage loans and mortgage-backed securities. Advances are made pursuant to several different credit programs offered from time to time by the FHLB. Unused lines of credit with the FHLB were \$181.7 million at December 31, 2006 and \$273.1 million at December 31, 2005.

At December 31, 2006, scheduled maturities of long-term borrowings with the FHLB are as follows:

| | <u>Balance</u> | <u>Weighted</u> |
|-----------------|-------------------------------|---------------------|
| | <u>(Dollars in thousands)</u> | <u>Average Rate</u> |
| 2007..... | \$ 55,000 | 4.08% |
| 2008..... | 45,000 | 4.98% |
| 2009..... | 40,750 | 4.13% |
| 2010..... | 14,000 | 4.34% |
| 2011..... | 30,000 | 4.84% |
| Thereafter..... | 55,000 | 3.86% |
| Total..... | <u>\$239,750</u> | <u>4.32%</u> |

Trust Preferred Securities

On September 28, 2005, HNC Statutory Trust III (Trust III), a newly formed Delaware statutory trust subsidiary of the Corporation, issued \$25.0 million of fixed/floating rate trust preferred securities which represent undivided beneficial interests in the assets of Trust III. Trust III issued mandatory redeemable preferred stock to investors and loaned the proceeds to the Corporation for general corporate purposes. Trust III holds, as its sole asset, a subordinated debenture in the amount of \$25.8 million issued by the Corporation on September 28, 2005. Trust III qualifies as a variable interest entity under FASB Interpretation 46, "Consolidation of Variable Interest Entities," as revised (FIN 46R). The trust preferred securities require quarterly distributions by Trust III to the holders of the trust preferred securities at a fixed rate equal to 5.67% through November 2010 and then will be payable at a variable interest rate equal to the three-month London Interbank Offered Rate (LIBOR) plus 1.40% per annum. The trust preferred securities must be redeemed upon maturity of the subordinate debentures on November 23, 2035. The Corporation may redeem the debentures prior to their stated maturity upon the occurrence of specified special events or at the specified optional redemption dates. The Corporation may redeem

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 10—Borrowings (Continued)

the debentures, in whole but not in part, at any time, within 90 days following the occurrence and continuation of a tax event, an investment company event or a capital treatment event as set forth in the indentures relating to the trust preferred securities and in each case subject to regulatory approval if required. The Corporation also may redeem the debentures, in whole or in part, at the stated optional redemption date of November 23, 2010, and quarterly thereafter, subject to regulatory approval if required. The special and optional redemption price is equal to 100% of the principal amount of the debentures being redeemed plus accrued and unpaid interest on the debentures to the redemption date.

On March 25, 2004, HNC Statutory Trust II (Trust II), a Delaware statutory trust subsidiary of the Corporation, issued \$20.0 million of floating rate (three-month LIBOR plus a margin of 2.70%) trust preferred securities, which represent undivided beneficial interests in the assets of Trust II. Trust II issued mandatory redeemable preferred stock to investors and loaned the proceeds to the Corporation. Trust II holds, as its sole asset, a subordinated debenture in the amount of \$20.6 million issued by the Corporation on March 25, 2004. Trust II qualifies as a variable interest entity under FIN 46R. The trust preferred securities must be redeemed upon maturity of the subordinate debentures on April 6, 2034. The Corporation may redeem the debentures prior to their stated maturity upon the occurrence of specified special events or at the specified optional redemption dates. The Corporation may redeem the debentures, in whole or in part, at any time, within 90 days following the occurrence and continuation of a tax event, an investment company event or a capital treatment event as set forth in the indentures relating to the trust preferred securities and in each case subject to regulatory approval if required. The Corporation also may redeem the debentures, in whole or in part, at the stated optional redemption date of April 7, 2009 and quarterly thereafter, subject to regulatory approval if required. The special and optional redemption price is equal to 100% of the principal amount of the debentures being redeemed plus accrued and unpaid interest on the debentures to the redemption date.

On February 22, 2001, the Corporation issued \$5.0 million of 10.2% junior subordinate deferrable interest debentures (the debentures) to Harleysville Statutory Trust I (Trust I), a Connecticut business trust, in which the Corporation owns all of the common equity. Trust I issued mandatorily redeemable preferred stock to investors and loaned the proceeds to the Corporation. Trust I qualifies as a variable interest entity under FIN 46R. The trust preferred securities must be redeemed upon maturity of the subordinate debentures on February 22, 2031. The Corporation may redeem the debentures prior to their stated maturity upon the occurrence of specified special events or at the specified optional redemption dates. The Corporation may redeem the debentures, in whole but not in part, at any time, within 90 days following the occurrence and continuation of a tax event, an investment company event or a capital treatment event as set forth in the indentures relating to the trust preferred securities and in each case subject to regulatory approval if required. If the special redemption date is before February 22, 2011, the special redemption price is the greater of (i) 100% of the principal amount of the debentures, plus accrued and unpaid interest on the debentures to the special redemption date, or (ii) as determined by a quotation agent, the sum of (a) the present value of the principal amount of the debentures at 105.10% of the principal amount and the present value of interest payable from the special redemption date to February 22, 2011, each discounted to the special redemption date on a semi-annual basis, plus (b) accrued and unpaid interest on the debentures to the special redemption date. If the special redemption date is on February 22, 2011, the redemption price is 105.10% of the principal amount, and declines annually to 100.00% on February 22, 2021 and thereafter, plus accrued and unpaid interest on the debentures to the redemption date. The Corporation also may redeem the debt securities, in whole or in part, at the stated optional redemption date of February 22, 2011 and semi-annually

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 10—Borrowings (Continued)

thereafter, subject to regulatory approval if required. The redemption price on February 22, 2011 is equal to 105.10% of the principal amount, and declines annually to 100.00% on February 22, 2021 and thereafter, plus accrued and unpaid interest on the debentures to the redemption date.

The Corporation's obligations under the debentures and related documents, taken together, constitute a full and unconditional guarantee by the Corporation of Trust I's, Trust II's and Trust III's obligations under the trust preferred securities.

In March 2005, the Federal Reserve Board adopted a final rule that allows the continued limited inclusion of outstanding and prospective issuances of trust preferred securities in Tier 1 capital of bank holding companies. Under the final rule, trust preferred securities and other restricted core capital elements will be subject to stricter quantitative limits. The Board's final rule limits restricted core capital elements to 25% of all core capital elements, net of goodwill, less any associated deferred tax liability. Amounts of restricted core capital elements in excess of these limits generally may be included in Tier 2 capital. The final rule provides a five-year transition period ending March 31, 2009, for application of the quantitative limits. In addition, the requirement for trust preferred securities to include a call option has been eliminated, and standards for the junior subordinated debt underlying trust preferred securities eligible for Tier 1 capital treatment have been clarified. Management has evaluated the effects of the rule and does not anticipate a material impact on its capital ratios upon implementation.

Note 11—Income Taxes

The components of income tax expense were as follows:

| | Year Ended December 31, | | |
|---------------------------------------|-------------------------|-----------------|-----------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Current income tax expense: | | | |
| Federal..... | \$13,221 | \$17,814 | \$16,029 |
| State..... | 162 | 119 | 117 |
| Total current income tax expense..... | 13,383 | 17,933 | 16,146 |
| Deferred federal income tax..... | 693 | (5,530) | (3,580) |
| Total income tax expense..... | <u>\$14,076</u> | <u>\$12,403</u> | <u>\$12,566</u> |

The effective income tax rates of 26.3% for 2006, 24.2% for 2005 and 24.6% for 2004 were less than the applicable federal income tax rate of 35% for each year. The reason for these differences follows:

| | Year Ended December 31, | | |
|--|-------------------------|-----------------|-----------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Expected income tax expense..... | \$18,779 | \$18,008 | \$17,972 |
| Tax-exempt income net of interest disallowance..... | (4,740) | (5,078) | (5,365) |
| Other..... | 37 | (201) | (41) |
| Tax benefit from sale of Cumberland Advisors, Inc..... | — | (326) | — |
| Actual income tax expense..... | <u>\$14,076</u> | <u>\$12,403</u> | <u>\$12,566</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 11—Income Taxes (Continued)

The tax effect of temporary differences that give rise to significant portions of deferred tax assets and liabilities are as follows:

| | 2006 | | 2005 | |
|--|------------------------|----------------|-----------------|----------------|
| | Asset | Liability | Asset | Liability |
| | (Dollars in thousands) | | | |
| Allowance for loan losses | \$ 7,404 | \$ — | \$ 6,768 | \$ — |
| Lease assets | — | 3,692 | — | 3,895 |
| Deferred loan fees | — | 2,637 | — | 2,214 |
| Deferred compensation | 2,796 | — | 2,798 | — |
| Pension | — | 102 | — | 106 |
| Stock-based compensation expense | 34 | — | — | — |
| Mortgage servicing rights | — | 917 | — | 279 |
| Depreciation | — | 288 | — | 690 |
| Net operating loss carryforward | 208 | — | 701 | — |
| Unrealized gain on investment securities | 2,623 | — | 4,801 | — |
| Net unrealized gain on derivative used for cash flow hedge | — | 164 | — | 160 |
| Unrealized loss on pension liability | 826 | — | — | — |
| Purchase accounting adjustments | — | 561 | — | 261 |
| Other | — | 989 | — | 873 |
| Total deferred taxes | <u>\$13,891</u> | <u>\$9,350</u> | <u>\$15,068</u> | <u>\$8,478</u> |

As a result of the adoption of SFAS No. 158 at December 31, 2006, the Corporation recorded a deferred tax asset of \$826,000 related to the recognition of the underfunded amount and the transition asset for its defined benefit pension plan. See Note 1 – Summary of Significant Accounting Pronouncements, *Recent Accounting Pronouncements* and Note 12 – Pension Plans for additional information.

The exercise of stock options which have been granted under the Corporation's various stock option plans gives rise to compensation, which is includible in the taxable income of the applicable employees and deductible by the Corporation for income tax purposes. At January 1, 2006, the Corporation began recognizing compensation expense for stock options with the adoption of SFAS 123(R) under the modified prospective application method of transition. Prior to this date, compensation resulting from increases in the fair market value of the Corporation's common stock subsequent to the date of grant of the applicable exercised stock options was not recognized, in accordance with APB Opinion No. 25, as an expense for financial accounting purposes. The Corporation may receive a tax deduction for applicable exercised options in a later period than the period in which the compensation cost is recognized in which a deferred tax asset is recognized for the deductible temporary difference based on the compensation cost recognized. If the deduction ultimately reported on the Corporation's tax return exceeds compensation cost recognized for financial reporting, the resulting tax benefit that exceeds the deferred tax asset for the award is recognized directly to additional paid in capital. The amounts recorded in paid in capital for 2006 and 2005 were \$1.3 million and \$1.1 million, respectively.

As a result of the acquisition of Millennium Bank during 2004, the Corporation had net operating loss carry forwards of approximately \$4.5 million. As of December 31, 2006, \$593,000 of these net operating losses remain and are scheduled to expire 2020 through 2024. The recognition of the net operating loss carry forward is subject to an annual limitation; however the Corporation expects to fully utilize the remaining carry forward.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 11—Income Taxes (Continued)

The Corporation acquired Cumberland Advisors as part of the Millennium Bank acquisition. Cumberland Advisors was subsequently sold in 2005. This sale generated a tax loss as a result of the tax basis exceeding the book basis of the net assets acquired. A tax benefit of approximately \$326,000 was recorded in 2005 associated with this sale. As of December 31, 2006, additional tax benefits of \$221,000 remain from this sale and are subject to certain limitations and will be utilized through 2016.

Note 12—Pension Plans

Defined Benefit Pension Plan

The Corporation has a non-contributory defined benefit pension plan covering substantially all employees. The plan's benefits are based on years of service and the employee's average compensation during any five consecutive years within the ten-year period preceding retirement.

In accordance with the implementation of SFAS No. 158, effective at the end of the fiscal year 2006, the Corporation recognized a liability for the underfunded status of its defined benefit pension plan in its statement of financial position and recognized as a component of accumulated other comprehensive income, net of tax, the net loss and transition asset that had not been included in the net periodic benefit cost of its pension plan. Prior to 2006, accounting standards required only disclosure of the funded status and unrecognized net losses and transition assets of the plan in the notes to the financial statements.

The following table illustrates the incremental effect of adopting SFAS No. 158, at December 31, 2006, on the Corporation's statement of financial position:

| Incremental Effect of Applying SFAS No. 158 on Individual Lines Items in the Balance Sheet December 31, 2006 | | | |
|---|--|-------------|---|
| | Before Application of SFAS No. 158 | Adjustments | After Application of SFAS No. 158 |
| | (Dollars in thousands) | | |
| Other assets ⁽¹⁾ | \$ 24,349 | \$ 826 | \$ 25,175 |
| Total assets | 3,249,002 | 826 | 3,249,828 |
| Other liabilities ⁽¹⁾ | 15,008 | 2,361 | 17,369 |
| Total liabilities | 2,952,716 | 2,361 | 2,955,077 |
| Accumulated other comprehensive loss | (4,568) | (1,535) | (6,103) |
| Total shareholders' equity | 296,286 | (1,535) | 294,751 |

(1) Includes recognition of deferred tax asset in other assets and liability for pension benefits in other liabilities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 12—Pension Plans (Continued)

The plan's funded status for the years ended December 31, 2006 and 2005 follow:

| | 2006 | 2005 |
|--|------------------------|------------------|
| | (Dollars in thousands) | |
| Change in benefit obligation: | | |
| Benefit obligation at beginning of year | \$11,052 | \$10,921 |
| Service cost | 1,041 | 1,052 |
| Interest cost | 654 | 642 |
| Actual loss | (199) | 308 |
| Benefits paid | (962) | (1,871) |
| Benefits obligation at end of year | <u>\$11,586</u> | <u>\$11,052</u> |
| Change in plan assets: | | |
| Fair value of plan assets at beginning of year | \$ 8,584 | \$ 8,469 |
| Actual return on plan assets | 703 | 486 |
| Employer contribution | 1,250 | 1,500 |
| Benefits paid | (962) | (1,871) |
| Fair value of plan assets at end of year | <u>\$ 9,575</u> | <u>\$ 8,584</u> |
| Funded status at end of year | <u>\$(2,011)</u> | <u>\$(2,468)</u> |
| Unrecognized transition asset | | (85) |
| Unrecognized net loss | | 2,860 |
| Prepaid benefit cost recognized | | <u>\$ 307</u> |

2006

Amounts recognized in accumulated other comprehensive loss (net of tax)

consist of:

| | |
|-------------------------------------|----------------|
| Net actuarial loss | \$1,579 |
| Transition asset | (44) |
| Total amount recognized, net of tax | <u>\$1,535</u> |

The accumulated benefit obligation for the defined benefit pension plan was \$8.9 million and \$8.1 million at December 31, 2006 and December 31, 2005, respectively.

Information for the Corporation's defined benefit pension plan with an accumulated benefit obligation in excess of plan assets follows:

| | Year Ended December 31, | |
|--------------------------------|----------------------------|----------|
| | 2006 | 2005 |
| | (Dollars in thousands) | |
| Projected benefit obligation | \$11,586 | \$11,052 |
| Accumulated benefit obligation | 8,865 | 8,139 |
| Fair value of plan assets | 9,575 | 8,584 |

**Weighted-average assumptions used to determine
pension plan obligations as of December 31,**

| | Year Ended December 31, | | |
|-------------------------------|----------------------------|-------|-------|
| | 2006 | 2005 | 2004 |
| Discount rate | 6.00% | 6.00% | 6.00% |
| Rate of compensation increase | 4.00% | 4.00% | 4.00% |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 12 – Pension Plans (Continued)

| Weighted-average assumptions used to determine Pension plan net periodic benefit cost as of December 31, | Year Ended December 31, | | |
|---|----------------------------|-------|-------|
| | 2006 | 2005 | 2004 |
| Discount rate | 6.00% | 6.00% | 6.00% |
| Expected return on plan assets | 6.00% | 6.00% | 6.50% |
| Rate of compensation increase | 4.00% | 4.00% | 4.00% |

| Components of net periodic defined benefit expense | Year Ended December 31, | | |
|---|----------------------------|----------------|--------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Service cost | \$1,041 | \$1,052 | \$873 |
| Interest cost | 654 | 642 | 564 |
| Expected return on plan assets | (551) | (524) | (477) |
| Amortization of prior service cost | — | — | (105) |
| Amortization of unrecognized net actuarial losses | 118 | 92 | 79 |
| Net periodic benefit expense | <u>\$1,262</u> | <u>\$1,262</u> | <u>\$934</u> |

The estimated net actuarial loss for the defined benefit plan that will be amortized from accumulated other comprehensive loss into net periodic pension cost during 2007 is \$49,000.

The pension plan assets are invested in a growth and income strategy with a target asset allocation of 60% equity and 40% fixed income securities. The allocation range for equities is between 55 to 65% and between 35 to 45% for fixed income. Long-term rate of return assumptions of the various asset classes are based primarily on empirical long-term historical return data, adjusted for near-term expectations. To make the return expectations more conservative, our near-term expectations are for 8.0% equity and 4.5% fixed income returns for the next 10 years. The expected 2007 employer contribution to the pension plan is \$1.3 million.

As of December 31, 2006 and 2005, Harleysville National Corporation's Pension Plan had an investment in the Corporation's stock with a market value of \$175,000 and \$165,000, respectively.

The Corporation's pension plan weighted-average asset allocations by asset category are as follows:

| Asset Category | Percentage of Plan Assets at December 31, | |
|-------------------------|---|---------------|
| | 2006 | 2005 |
| Equity securities | 59.7% | 65.6% |
| Debt securities | 33.1% | 32.5% |
| Other | 7.2% | 1.9% |
| Total | <u>100.0%</u> | <u>100.0%</u> |

Supplemental Benefit Plans

The Corporation maintains a Supplemental Executive Retirement Plan for certain officers and key employees. The plan provides for payment to the covered employee of an annual supplemental retirement benefit up to 50% of their average annual compensation upon retirement, thereafter offset by the employer's share of social security, defined benefit pension and available employer's 401(k) matching contribution. There is a lifetime payout in retirement benefits with a minimum payout of 10 years. There is a pre-retirement death benefit, payable for

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 12—Pension Plans (Continued)

10 years, of 100% of the average annual compensation for the first year, and up to 50% of the average annual compensation for the next 9 years. The Corporation's liability under these agreements is being accrued over the participants' remaining service period. The accrued benefit obligation as of December 31, 2006 and 2005 was \$5.4 million and \$5.5 million, respectively.

Defined Contribution Plan

The Corporation maintains a 401(k) defined contribution retirement savings plan which allows employees to contribute a portion of their compensation on a pre-tax and/or after-tax basis in accordance with specified guidelines. The Corporation matches 50% of pre-tax employee contributions up to a maximum of 3%. Contributions charged to earnings were \$628,000, \$569,000 and \$514,000 for 2006, 2005 and 2004, respectively.

Note 13—Stock Repurchase Program and Stock Dividend

The Corporation has a stock repurchase program that permits the repurchase of up to five percent of its outstanding common stock. The repurchased shares will be used for general corporate purposes. On December 14, 2000, the Board of Directors authorized a program to purchase up to 1,377,023 shares (restated for stock dividends and splits), or 5%, of its outstanding common stock. This repurchase plan was completed during the second quarter of 2005. On May 12, 2005, the Board of Directors authorized a plan to purchase up to 1,416,712 shares (restated for five percent stock dividend paid on September 15, 2006 and September 15, 2005) or 4.9%, of its outstanding common stock. As of December 31, 2006, the maximum number of shares that may yet be purchased under the plan is 872,761.

On September 15, 2006, the Corporation paid a five percent stock dividend on its common stock to shareholders of record as of September 1, 2006.

On September 15, 2005, the Corporation paid a five percent stock dividend on its common stock to shareholders of record as of September 1, 2005.

On September 15, 2004, the Corporation paid a five percent stock dividend on its common stock to shareholders of record as of August 30, 2004.

All prior period amounts in the consolidated financial statements and footnotes have been restated to reflect these stock dividends.

Note 14—Stock-Based Compensation

The Corporation has four shareholder approved fixed stock option plans that allow the Corporation to grant options up to an aggregate of 3,797,861 shares of common stock to key employees and directors. At December 31, 2006, 2,516,882 stock options had been granted under the stock option plans. The options have a term of ten years when issued and typically vest over a five-year period. The exercise price of each option is the market price of the Corporation's stock on the date of grant. Additionally, at December 31, 2006, the Corporation has an additional 328,327 granted stock options as a result of the Millennium Bank acquisition. The options have a term of ten years and are exercisable at prices ranging from \$9.25 to \$13.81.

At January 1, 2006, the Corporation began recognizing compensation expense for stock options with the adoption of SFAS 123(R) under the modified prospective application method of transition. Prior to January 1, 2006, the Corporation followed SFAS 123 and APB 25 with *pro forma* disclosures of net income and earnings per share, as if the fair value-based method of accounting defined in SFAS 123 has been applied. Effective January 1, 2006, the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 14—Stock-Based Compensation (Continued)

Corporation recognizes compensation expense for the portion of outstanding awards at January 1, 2006 for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS 123 for pro forma disclosures. For new grants awarded on or after January 1, 2006, the Corporation has chosen to continue the use of the Black-Scholes option-pricing model (as used under SFAS 123) to estimate the fair value of each option on the date of grant. See Note 1 – Summary of Significant Accounting Policies for additional information.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions based on historical data used for grants in 2006, 2005 and 2004, respectively: weighted-average dividend yield of 3.52%, 3.27% and 2.83%; weighted-average expected volatility of 32.19%, 31.15% and 29.38%; weighted average risk-free interest rate of 4.64% (4.42% to 5.08%), 4.41% (3.79% to 4.57%) and 4.06% and a weighted-average expected life of 7.28 years, 7.15 years and 7.06 years. Expected volatility is based on the historical volatility of the Corporation's stock over the expected life of the grant. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury strip rate in effect at the time of the grant. The life of the option is based on historical factors which include the contractual term, vesting period, exercise behavior and employee terminations. In accordance with SFAS 123(R), stock based compensation expense for the year ended December 31, 2006 is based on awards that are ultimately expected to vest and therefore has been reduced for estimated forfeitures. The Corporation estimates forfeitures using historical data based upon the groups identified by management. Prior to January 1, 2006, under SFAS 123, forfeitures were accounted for as they occurred. As a result of adopting SFAS 123(R) on January 1, 2006, the Corporation's income before income taxes and net income were lower than if it had continued to account for share-based compensation under APB 25 by \$440,000 and \$407,000, respectively, for the year ended December 31, 2006. Basic and diluted earnings per share were lower by \$.01 for the year ended December 31, 2006 as a result of the adoption of SFAS 123(R).

The following table illustrates the effect on net income and earnings per share if the Corporation had applied the fair value recognition provisions of SFAS 123(R) to stock-based employee compensation for the years ended December 31, 2005 and December 31, 2004 (all per share information has been adjusted retroactively for the effect of stock dividends). See Note 15, "Earnings Per Share," for calculation of earnings per share.

| | <u>Year ended December 31,</u> | |
|--|--------------------------------------|-----------------|
| | <u>2005</u> | <u>2004</u> |
| | <u>(Dollars in thousands,</u> | |
| | <u>except per share information)</u> | |
| Net income | | |
| As reported | \$38,828 | \$38,567 |
| Stock-based compensation expense included in reported net income, net of related tax effects | — | — |
| Stock-based compensation expense determined under fair value based method for all awards, net of related tax effects | (602) | (1,148) |
| <i>Pro forma</i> | <u>\$38,226</u> | <u>\$37,419</u> |
| Earnings per share (Basic) | | |
| As reported | \$ 1.34 | \$ 1.35 |
| <i>Pro forma</i> | \$ 1.32 | \$ 1.31 |
| Earnings per share (Diluted) | | |
| As reported | \$ 1.32 | \$ 1.31 |
| <i>Pro forma</i> | \$ 1.30 | \$ 1.27 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 14—Stock-Based Compensation (Continued)

The Corporation has the following shareholder approved fixed stock option plans that are maintained to advance the development, growth and financial condition of the Corporation as described below. In connection with the acquisition of Millennium Bank in 2004, the Corporation assumed all obligations under the Millennium Bank Stock Compensation Program. All share information has been adjusted to reflect stock dividends. For additional information on the accounting for share-based compensation plans, see Note 1, "Significant Accounting Policies—Stock-Based Compensation."

1998 Independent Directors Stock Option Plan: This plan provides that shares of the Corporation's stock be issued to non-employee directors. During 2006, there were 6,000 shares granted under the plan. As of December 31, 2006, a total of 47,098 shares remained available for grant under the plan. At December 31, 2006, there were 266,829 options outstanding under the plan.

1993 Stock Incentive Plan: This plan provides that shares of the Corporation's common stock be issued to certain employees of the Corporation and the Bank. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock. No stock options remain available for grant under the 1993 Stock Incentive Plan. At December 31, 2006, there were 21,081 options outstanding under the plan.

1998 Stock Incentive Plan: This plan provides that shares of the Corporation's common stock be issued to certain employees of the Corporation and the Bank. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock. As of December 31, 2006, a total of 80,770 stock options remained available for grant under the plan. During 2006, no stock options were granted. At December 31, 2006, there were 849,884 options outstanding under the plan.

2004 Omnibus Stock Incentive: This plan provides that shares of the Corporation's common stock be issued to certain employees and/or directors of the Corporation and the Bank. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock. During 2006, there were 12,900 shares granted under the plan. As of December 31, 2006, stock options of 1,144,725 remain available for grant. At December 31, 2006, there were 12,900 options outstanding under the plan.

Millennium Stock Compensation Program Converted to Harleysville Stock Options: In connection with the acquisition of Millennium Bank in 2004, the Corporation assumed all obligations under the Millennium Bank Stock Compensation Program. The change in control accelerated the vesting of all outstanding stock options to 100%. Upon consummation of the merger, outstanding stock options were converted according to pro-ratio parameters outlined in the merger agreement. Stock options totaling 328,327 were assumed on the effective date of the merger. In conjunction with the sale of Cumberland Advisors, Inc. which took place in the second quarter of 2005, 36,209 non-qualified performance based stock options were cancelled. A total of 6,789 stock options remain outstanding under the program at December 31, 2006. No further stock options may be granted under the program.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 14—Stock-Based Compensation (Continued)

A summary of option activity under the Corporation's stock option plans as of December 31, 2006 and changes during the year then ended is presented in the following table. The number of shares and weighted-average share information have been adjusted to reflect stock dividends.

Options

| | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value (in thousands) |
|----------------------------------|------------------|------------------------------------|--|--|
| Outstanding at January 1, 2006 | 1,650,387 | \$14.27 | | |
| Granted | 18,900 | 18.60 | | |
| Exercised | (427,081) | 9.50 | | |
| Forfeited (unvested) | (57,911) | 22.72 | | |
| Cancelled (vested) | (26,811) | 17.81 | | |
| Outstanding at December 31, 2006 | <u>1,157,484</u> | <u>\$15.60</u> | <u>5.40</u> | <u>\$6,457</u> |
| Exercisable at December 31, 2006 | <u>1,025,875</u> | <u>\$14.75</u> | <u>5.02</u> | <u>\$6,457</u> |

The weighted-average grant-date fair value of options granted during the years ended December 31, 2006, 2005 and 2004 were \$5.23, \$5.83 and \$6.78, respectively. The total intrinsic value of options exercised during the years ended December 31, 2006, 2005 and 2004 were \$4.6 million, \$3.6 million and \$6.5 million, respectively. Intrinsic value is measured using the fair market value price of the Corporation's common stock less the applicable exercise price.

A summary of the status of the Corporation's nonvested shares as of December 31, 2006 is as follows:

| Nonvested Shares | Shares | Weighted-Average Grant-Date Fair Value |
|--------------------------------|-----------------|---|
| Nonvested at January 1, 2006 | 229,671 | \$6.24 |
| Granted | 18,900 | 5.23 |
| Vested | (59,050) | 6.10 |
| Forfeited | <u>(57,911)</u> | 6.28 |
| Nonvested at December 31, 2006 | <u>131,610</u> | \$6.15 |

As of December 31, 2006, there was a total of \$734,000 of unrecognized compensation cost related to nonvested awards under stock option plans. This cost is expected to be recognized over a weighted-average period of 1.7 years. The total fair value of shares vested during the years ended December 31, 2006, 2005 and 2004 were \$360,000, \$1.1 million and \$1.9 million, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 14—Stock-Based Compensation (Continued)

Prior to the adoption of SFAS 123(R), the Corporation presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the statement of cash flows. Statement 123(R) requires the cash flows resulting from tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The \$948,000 excess tax benefit classified as a financing cash inflow would have been classified as an operating cash inflow if the company had not adopted SFAS 123(R).

In addition, the Corporation maintains the Harleysville National Corporation Stock Bonus Plan to award employees in recognition of exemplary service during each calendar year. The Corporation's Board of Directors authorized the registration of 70,354 shares of common stock for issuance under this plan in December 1996. The Stock Bonus Plan is administered by the Compensation Committee of the Corporation. The committee annually determines, in its sole discretion, the amount of shares the Corporation awards. The Corporation awarded 227 shares during 2006. As of December 31, 2006, a total of 23,043 shares remained available for awards under the plan.

Note 15—Earnings Per Share

The calculations of basic earnings per share and diluted earnings per share are presented below. All weighted average shares, actual shares and per share information in the financial statements have been adjusted retroactively for the effect of stock dividends and splits. See Note 1 of the consolidated financial statements for a discussion on the calculation of earnings per share.

| | Year Ended December 31, | | |
|---|--|------------|------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands, except per share information) | | |
| Basic earnings per share | | | |
| Net income available to common shareholders | \$ 39,415 | \$ 38,828 | \$ 38,567 |
| Weighted average common shares outstanding | 28,946,847 | 28,891,412 | 28,505,392 |
| Basic earnings per share | \$ 1.36 | \$ 1.34 | \$ 1.35 |
| Diluted earnings per share | | | |
| Net income available to common shareholders and assumed conversions | \$ 39,415 | \$ 38,828 | \$ 38,567 |
| Weighted average common shares outstanding | 28,946,847 | 28,891,412 | 28,505,392 |
| Dilutive potential common shares(1),(2) | 406,281 | 598,804 | 960,221 |
| Total diluted weighted average common shares outstanding | 29,353,128 | 29,490,216 | 29,465,613 |
| Diluted earnings per share | \$ 1.34 | \$ 1.32 | \$ 1.31 |

- (1) Includes incremental shares from assumed conversions of stock options.
- (2) Antidilutive options have been excluded in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common stock. For 2006, 2005, and 2004, there were 416,353, 372,471 and 329,764 antidilutive options at an average price of \$24.50, \$25.65 and \$25.94 per share, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 16—Comprehensive Income

The components of other comprehensive income (loss) are as follows:

| <u>For the year ended December 31, 2006</u> | <u>Before tax amount</u> | <u>Tax Benefit (Expense)</u> (Dollars in thousands) | <u>Net of tax amount</u> |
|--|------------------------------|--|------------------------------|
| Net unrealized gains on available for sale securities: | | | |
| Net unrealized holding gains arising during period | \$5,548 | \$(1,942) | \$3,606 |
| Less reclassification adjustment for net losses realized in net income | (674) | 236 | (438) |
| Net unrealized gains | 6,222 | (2,178) | 4,044 |
| Defined benefit pension plan ⁽¹⁾ | | | |
| Net loss | (2,429) | 850 | (1,579) |
| Transition asset | 68 | (24) | 44 |
| Defined benefit pension plan, net | (2,361) | 826 | (1,535) |
| Change in fair value of derivatives used for cash flow hedges | (141) | 49 | (92) |
| Amortization of unrealized loss on termination of cash flow hedge | 151 | (53) | 98 |
| Other comprehensive income, net | <u>\$3,871</u> | <u>\$(1,356)</u> | <u>\$2,515</u> |
| <u>For the year ended December 31, 2005</u> | <u>Before tax amount</u> | <u>Tax Benefit (Expense)</u> (Dollars in thousands) | <u>Net of tax amount</u> |
| Net unrealized losses on available for sale securities: | | | |
| Net unrealized holding losses arising during period | \$(10,783) | \$ 3,774 | \$(7,009) |
| Less reclassification adjustment for net gains realized in net income | 4,794 | (1,678) | 3,116 |
| Net unrealized losses | (15,577) | 5,452 | (10,125) |
| Change in fair value of derivatives used for cash flow hedges | 557 | (195) | 362 |
| Unrealized loss on termination of cash flow hedge | (151) | 53 | (98) |
| Other comprehensive loss, net | <u>\$(15,171)</u> | <u>\$ 5,310</u> | <u>\$(9,861)</u> |
| <u>For the year ended December 31, 2004</u> | <u>Before tax amount</u> | <u>Tax Benefit (Expense)</u> (Dollars in thousands) | <u>Net of tax amount</u> |
| Net unrealized losses on available for sale securities: | | | |
| Net unrealized holding losses arising during period | \$ (7,350) | \$2,573 | \$(4,777) |
| Less reclassification adjustment for net gains realized in net income | 3,689 | (1,291) | 2,398 |
| Net unrealized losses | (11,039) | 3,864 | (7,175) |
| Change in minimum pension liability | 459 | — | 459 |
| Change in fair value of derivatives used for cash flow hedges | (214) | 75 | (139) |
| Other comprehensive loss, net | <u>\$(10,794)</u> | <u>\$3,939</u> | <u>\$(6,855)</u> |

- (1) Adjustment to initially adopt SFAS No. 158 as of December 31, 2006. See Note 1 – Summary of Significant Accounting Policies, *Recent Accounting Pronouncements* and Note 12 – Pension Plans for additional information.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 17—Segment Information

The Corporation operates two main lines of business along with several other operating segments. SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" establishes standards for the way public business enterprises report information about operating segments. Operating segments are components of an enterprise, which are evaluated regularly by the chief operating decision-maker in deciding how to allocate and assess resources and performance. The Corporation's chief operating decision-maker is the President and Chief Executive Officer. The Corporation has applied the aggregation criteria set forth in SFAS No. 131, for operating segments establishing two reportable segments: Community Banking and Wealth Management.

The Community Banking segment provides financial services to consumers, businesses and governmental units primarily in southeastern Pennsylvania. These services include full-service banking, comprised of accepting time and demand deposits, making secured and unsecured commercial loans, mortgages, consumer loans, and other banking services. The treasury function income is included in the Community Banking segment, as the majority of effort of this function is related to this segment. Primary sources of income include net interest income and service fees on deposit accounts. Expenses include costs to manage credit and interest rate risk, personnel, and branch operational and technical support.

The Wealth Management segment includes: trust and investment management services, providing investment management, trust and fiduciary services, estate settlement and executor services, financial planning, and retirement plan and institutional investment services; and the Cornerstone Companies, registered investment advisors for high net worth, privately held business owners, wealthy families and institutional clients. Major revenue components sources include investment management and advisory fees, trust fees, estate and tax planning fees, brokerage fees, and insurance related fees. Expenses primarily consist of personnel and support charges. Additionally, the Wealth Management segment includes an inter-segment credit related to trust deposits which are maintained within the Community Banking segment using a transfer pricing methodology.

The Corporation has also identified several other operating segments. These operating segments within the Corporation's operations do not have similar characteristics to the Community Banking or Wealth Management segments and do not meet the quantitative thresholds requiring separate disclosure. These non-reportable segments include HNC Reinsurance Company, HNC Financial Company, and the parent holding company and are included in the "Other" category.

Information about reportable segments and reconciliation of the information to the consolidated financial statements follows:

| | Community Banking | Wealth Management (Dollars in thousands) | All Other | Consolidated Totals |
|---|----------------------|---|------------|---------------------|
| Year Ended December 31, 2006 | | | | |
| Net interest income (expense) | \$ 84,775 | \$ 470 | \$ (2,072) | \$ 83,173 |
| Provision for loan losses | 4,200 | | | 4,200 |
| Noninterest income | 29,735 | 14,975 | 735 | 45,445 |
| Noninterest expense | 56,049 | 13,650 | 1,228 | 70,927 |
| Income (loss) before income taxes (benefit) | 54,261 | 1,795 | (2,565) | 53,491 |
| Income taxes (benefit) | 14,475 | 717 | (1,116) | 14,076 |
| Net income (loss) | \$ 39,786 | \$ 1,078 | \$ (1,449) | \$ 39,415 |
| Assets | \$3,195,051 | \$ 19,475 | \$ 35,302 | \$3,249,828 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 17—Segment Information (Continued)

| | Community Banking | Wealth Management (Dollars in thousands) | All Other | Consolidated Totals |
|---|----------------------|---|-----------|---------------------|
| Year Ended December 31, 2005 | | | | |
| Net interest income (expense) | \$ 87,105 | \$ 620 | \$ (604) | \$ 87,121 |
| Provision for loan losses | 3,401 | | | 3,401 |
| Noninterest income | 20,512 | 6,690 | 2,788 | 29,990 |
| Noninterest expense | 55,129 | 7,078 | 272 | 62,479 |
| Income before income taxes | 49,087 | 232 | 1,912 | 51,231 |
| Income taxes | 11,927 | 81 | 395 | 12,403 |
| Net income | \$ 37,160 | \$ 151 | \$ 1,517 | \$ 38,828 |
| Assets | \$3,084,303 | \$ 51 | \$33,005 | \$ 3,117,359 |
| Year Ended December 31, 2004 | | | | |
| Net interest income | \$ 84,344 | \$ 481 | \$ 266 | \$ 85,091 |
| Provision for loan losses | 2,555 | | | 2,555 |
| Noninterest income | 19,012 | 6,547 | 2,599 | 28,158 |
| Noninterest expense | 51,981 | 7,513 | 67 | 59,561 |
| Income (loss) before income taxes (benefit) | 48,820 | (485) | 2,798 | 51,133 |
| Income taxes (benefit) | 11,999 | (169) | 736 | 12,566 |
| Net income (loss) | \$ 36,821 | \$ (316) | \$ 2,062 | \$ 38,567 |
| Assets | \$2,984,067 | \$1,887 | \$38,561 | \$3,024,515 |

The accounting policies of the segments are the same as those described in the summary of significant accounting policies disclosed in Note 1 of the consolidated financial statements. Consolidating adjustments reflecting certain eliminations of inter-segment revenues, cash and investment in subsidiaries are included in the "All Other" segment.

Note 18—Lease Commitments and Contingent Liabilities

Lease Commitments

Lease commitments for equipment and banking locations expire intermittently over the years through 2036. Most banking location leases require the lessor to pay insurance, maintenance costs, and property taxes. Approximate minimum rental commitments for non-cancelable operating leases at December 31, 2006, are as follows:

| | Minimum Lease Payments (Dollars in thousands) |
|-----------------------------|---|
| For the year ending: | |
| 2007..... | \$ 2,343 |
| 2008..... | 2,344 |
| 2009..... | 2,013 |
| 2010..... | 1,901 |
| 2011..... | 1,802 |
| Thereafter..... | 19,948 |
| Total..... | <u>\$30,351</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 18—Lease Commitments and Contingent Liabilities (Continued)

Total rent expense amounted to \$2.4 million for each of the years ended December 31, 2006, 2005 and 2004, respectively.

Other

Based on consultation with the Corporation's legal counsel, management is not aware of any litigation that would have a material adverse effect on the consolidated financial position of the Corporation. There are no proceedings pending other than the ordinary routine litigation incident to the business of the Corporation. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation by government authorities.

Note 19—Financial Instruments with Off-Balance Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual or notional amounts of those instruments. The Bank uses the same stringent credit policies in extending these commitments as they do for recorded financial instruments and controls exposure to loss through credit approval and monitoring procedures. These commitments often expire without being drawn upon and often are secured with appropriate collateral; therefore, the total commitment amount does not necessarily represent the actual risk of loss or future cash requirements.

The Bank offers commercial, mortgage and consumer credit products to its customers in the normal course of business. These products represent a diversified credit portfolio and are generally issued to borrowers within the Bank's branch office systems in eastern Pennsylvania. The ability of the customers to repay their credits is, to some extent, dependent upon the economy in the Bank's market areas.

The approximate contract amounts are as follows:

| <u>Commitments</u> | <u>Total Amount Committed at December 31,</u> | |
|---|---|-------------|
| | <u>2006</u> | <u>2005</u> |
| | <u>(Dollars in thousands)</u> | |
| Financial instruments whose contract amounts represent credit risk: | | |
| Commitments to extend credit | \$753,825 | \$722,034 |
| Standby letters of credit and financial guarantees written | 25,960 | 21,661 |
| Financial instruments whose notional or contract amounts exceed the amount of credit risk: | | |
| Interest rate swap agreements | 59,750 | 22,100 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 19—Financial Instruments with Off-Balance Sheet Risk (Continued)

The total commitment to extend credit included no credit card unused lines at December 31, 2006 and \$44.4 million at December 31, 2005. In April 2006, the Corporation sold its existing credit card portfolio. See Note 2—Acquisitions / Dispositions for additional information.

Standby letters of credit expire as follows: \$23.2 million in one year or less, \$1.1 million after one year through three years, \$38,000 after three years through five years and \$1.6 million after five years.

At December 31, 2006, the Corporation had cash flow hedges in the form of interest-rate swaps with a notional amount of \$45.0 million that have the effect of converting the rates on money market deposit accounts to a fixed-rate cost of funds. This strategy will cause the Corporation to recognize, in a rising rate environment, a larger interest rate spread than it otherwise would have without the swaps in effect. In addition, the Corporation had cash flow hedges with a notional amount of \$10.0 million that have the effect of converting variable debt to a fixed rate. For these swaps, the Corporation recognized net interest income of \$442,000 and \$69,000 for the years ended December 31, 2006 and 2005 and estimates that for 2007, \$429,000 will be recognized as an increase in net interest income. These swaps mature in 2008. During the first quarter of 2005, the Corporation terminated a cash flow hedge with a notional value of \$25.0 million. The gross loss related to the termination of this swap was \$310,000 which was amortized through October 2006 in accordance with SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities." For the years ended December 31, 2006 and 2005, the Corporation amortized into net interest income \$151,000 and \$159,000, respectively related to this swap. Periodically, the Corporation may enter into fair value hedges to limit the exposure to changes in the fair value of loan assets. The Corporation has entered into fair value hedges with a notional amount of \$4.8 million with \$7,000 of interest income recognized for the year ended December 31, 2006. These swaps mature in 2015 through 2016. At December 31, 2006, the Corporation had swap agreements with a positive fair value of \$545,000 and with a negative fair value of \$21,000. At December 31, 2005, the swaps had a positive fair value of \$623,000. There was no hedge ineffectiveness recognized during 2006, 2005 and 2004.

The Bank also had commitments with customers to extend mortgage loans at a specified rate at December 31, 2006 and 2005 of \$2.3 million and \$1.8 million, respectively and commitments to sell mortgage loans at a specified rate at December 31, 2006 and 2005 of \$792,000 and \$1.1 million, respectively. The commitments are accounted for as a derivative and recorded at fair value. The Bank estimates the fair value of these commitments by comparing the secondary market price at the reporting date to the price specified in the contract to extend or sell the loan initiated at the time of the loan commitment. At December 31, 2006 and 2005, the fair values of the loan commitments were \$12,000 and \$320, respectively, which were recorded as other income.

During April 2006, the Bank sold its existing credit card portfolio of \$15.3 million. The sale agreement stipulates that any credit card accounts delinquent over 30 days, overlimit accounts and petitioned bankruptcies will be guaranteed by the Bank for a period of one year. Of the \$15.3 million in credit card receivables sold, \$529,000 was sold with full recourse which was the total potential recourse exposure at the time of the sale. During the second quarter of 2006, the Bank recorded a recourse liability of \$371,000 which was the entire recourse liability recorded. This estimate was based on our historic losses as experienced on similar credit card receivables. The Bank will be subject to the full recourse obligations for a period of one year. At December 31, 2006, the total potential recourse exposure had been reduced to \$195,000 with a current recourse liability of \$96,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 19—Financial Instruments with Off-Balance Sheet Risk (Continued)

During December 2004 and January 2005, the Bank sold lease financing receivables of \$10.5 million. Of these leases, \$1.2 million were sold with full recourse and the remaining leases were sold subject to recourse with a maximum exposure of ten percent of the outstanding receivable. The total recourse exposure at the time of the sale of the leases was \$2.0 million. During the first quarter of 2005, the Bank recorded a recourse liability of \$216,000 which was the entire recourse liability recorded. This estimate was based on our historic losses as experienced on similar lease financing receivables. After the first anniversary of the sale agreement, and on a quarterly basis thereafter, upon written request by the Bank, the purchaser will review the portfolio performance and may reduce the total exposure to an amount equal to ten percent of the outstanding net book value. The Bank will be subject to the full and partial recourse obligations until all the lease financing receivables have been paid or otherwise been terminated and all equipment has been sold or disposed of. The final lease payment is due in 2010 with approximately 85% of the lease financing receivables estimated to be paid down by December 31, 2007. The outstanding balance of these sold leases at December 31, 2006 was \$3.0 million with a total recourse exposure of \$709,000 and a current recourse liability of \$64,000.

Note 20—Regulatory Capital

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provision | |
|--|-----------|--------|-------------------------------|-------|---|-------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2006 | | | | | | |
| | | | (Dollars in thousands) | | | |
| <i>Total Capital (to risk weighted assets):</i> | | | | | | |
| Corporation | \$323,622 | 12.58% | \$205,814 | 8.00% | \$257,268 | — |
| Harleysville National Bank | 279,513 | 10.93% | 204,529 | 8.00% | 255,661 | 10% |
| <i>Tier 1 Capital (to risk weighted assets):</i> | | | | | | |
| Corporation | 302,368 | 11.75% | 102,907 | 4.00% | 154,361 | — |
| Harleysville National Bank | 258,259 | 10.10% | 102,264 | 4.00% | 153,397 | 6% |
| <i>Tier 1 Capital (to average assets):</i> | | | | | | |
| Corporation | 302,368 | 9.36% | 129,242 | 4.00% | 161,553 | — |
| Harleysville National Bank | 258,259 | 8.08% | 127,877 | 4.00% | 159,846 | 5% |
| As of December 31, 2005 | | | | | | |
| | | | (Dollars in thousands) | | | |
| <i>Total Capital (to risk weighted assets):</i> | | | | | | |
| Corporation | \$318,911 | 12.98% | \$196,563 | 8.00% | \$245,703 | — |
| Harleysville National Bank | 259,883 | 10.64% | 195,390 | 8.00% | 244,238 | 10% |
| <i>Tier 1 Capital (to risk weighted assets):</i> | | | | | | |
| Corporation | 298,946 | 12.17% | 98,281 | 4.00% | 147,422 | — |
| Harleysville National Bank | 239,918 | 9.82% | 97,695 | 4.00% | 146,543 | 6% |
| <i>Tier 1 Capital (to average assets):</i> | | | | | | |
| Corporation | 298,946 | 9.69% | 123,408 | 4.00% | 154,260 | — |
| Harleysville National Bank | 239,918 | 7.86% | 122,154 | 4.00% | 152,693 | 5% |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 20—Regulatory Capital (Continued)

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table) of total and Tier 1 capital to risk-weighted assets. Management believes, as of December 31, 2006, that the Bank meets all capital adequacy requirements to which it is subject. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events that have occurred that management believes have changed the Bank's category.

The National Banking Laws require the approval of the Office of the Comptroller of the Currency if the total of all dividends declared by a national bank in any calendar year exceed the net profits of the bank (as defined) for that year combined with its retained net profits for the preceding two calendar years. Under this formula, the Bank may declare dividends in 2007 of approximately \$35.7 million plus an amount equal to the net profits of the Bank in 2007 up to the date of any such dividend declaration.

Banking regulations limit the amount of investments, loans, extensions of credit and advances that a subsidiary bank can make to an affiliate at any time to 10% and in the aggregate or to a single financial subsidiary, to 20% of the Bank's capital stock and surplus. These regulations also require that certain covered transactions including a loan, extension of credit or advance to an affiliate be secured by securities having a market value in excess of the amount thereof. At December 31, 2006, the Bank's investment in the Cornerstone Companies (a financial subsidiary) of \$16.7 million was in compliance with the limitations and not subject to collateral requirements.

Note 21—Fair Value of Financial Instruments

SFAS No. 107, "Disclosures about Fair Values of Financial Instruments," requires disclosure of the estimated fair value of an entity's assets and liabilities considered to be financial instruments. For the Corporation, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments as defined in SFAS No. 107. However, many such instruments lack an available trading market, as characterized by a willing buyer and seller engaging in an exchange transaction. Also, it is the Corporation's general practice and intent to hold its financial instruments to maturity and not to engage in trading or sales activities, except for certain loans and investments. Therefore, the Corporation had to use significant estimates and present value calculations to prepare this disclosure.

Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Also, management is concerned that there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 21—Fair Value of Financial Instruments (Continued)

Estimated fair values have been determined by the Corporation using the best available data and an estimation methodology suitable for each category of financial instruments. The estimation methodologies used at December 31, 2006 and 2005 are outlined as follows:

Short-term financial instruments

The carrying value of short-term financial instruments including cash and due from banks, federal funds sold and securities purchased under agreements to resell, interest-bearing deposits in banks and other short-term investments and borrowings, approximates the fair value of these instruments. These financial instruments generally expose the Corporation to limited credit risk and have no stated maturities or have short-term maturities with interest rates that approximate market rates.

Investment securities

The estimated fair values of investment securities are based on quoted market prices; if available. Estimated fair values are based on quoted market prices of comparable instruments if quoted market prices are not available.

Loans

The loan portfolio, net of unearned income, has been valued using a present value discounted cash flow analysis where market prices were not available. The discount rate used in these calculations is the estimated current market rate adjusted for credit risk.

Deposits

The estimated fair values of demand deposits (i.e., interest and noninterest-bearing checking accounts, savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The carrying amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. The fair value for deposits with stated maturities was calculated by discounting contractual cash flows using current market rates for instruments with similar maturities. The carrying amount of accrued interest receivable and payable approximates fair value.

Long-term borrowings and subordinated debt

The amounts assigned to long-term borrowings and subordinated debt were based on quoted market prices, when available, or were based on discounted cash flow calculations using prevailing market interest rates for debt of similar terms.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 21—Fair Value of Financial Instruments (Continued)

Off-balance sheet instruments

The fair value of commitments to extend credit is estimated based on the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based on the amount of unearned fees plus the estimated cost to terminate the letters of credit. Fair values of unrecognized financial instruments including commitments to extend credit and the fair value of letters of credit are considered immaterial.

The fair value of interest rate swaps are based upon the estimated amount the Corporation would receive or pay to terminate the contracts or agreements, taking into account current interest rates and, when appropriate, the current creditworthiness of the counterparties. The fair value of the interest rate swap agreements are \$524,000 at December 31, 2006 and \$623,000 at December 31, 2005.

The carrying and fair values of certain financial instruments were as follows:

| | December 31, | | | |
|---|------------------------|---------------|--------------------|---------------|
| | 2006 | | 2005 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (Dollars in thousands) | | | |
| Investment securities | \$ 911,889 | \$ 912,307 | \$ 901,208 | \$ 901,406 |
| Loans, net | 2,047,355 | 2,045,513 | 1,985,493 | 1,946,051 |
| Time deposits | 852,572 | 849,052 | 756,658 | 753,008 |
| Long-term borrowings and subordinated debt | 291,298 | 281,246 | 349,298 | 343,882 |
| Bank-owned life insurance | 61,720 | 61,720 | 59,334 | 59,334 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 22—Parent-Company Only Financial Information

Condensed financial statements of Harleysville National Corporation follow:

CONDENSED BALANCE SHEETS

| | December 31, | |
|--|------------------------|------------------|
| | 2006 | 2005 |
| | (Dollars in thousands) | |
| Assets | | |
| Cash | \$ 11,835 | \$ 26,152 |
| Investments in subsidiaries | 332,461 | 294,726 |
| Other investments | 1,548 | 1,548 |
| Other assets | 1,213 | 3,025 |
| Total assets | <u>\$347,057</u> | <u>\$325,451</u> |
| Liabilities and shareholders' equity | | |
| Subordinated debt | \$ 51,548 | \$ 51,548 |
| Other liabilities | 758 | 671 |
| Total liabilities | 52,306 | 52,219 |
| Shareholders' equity | 294,751 | 273,232 |
| Total liabilities and shareholders' equity | <u>\$347,057</u> | <u>\$325,451</u> |

CONDENSED STATEMENTS OF INCOME

| | Year Ended December 31, | | |
|---|-------------------------|-----------------|-----------------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Dividends from subsidiaries | \$21,779 | \$26,638 | \$18,575 |
| Interest from subsidiaries | 290 | 191 | — |
| Investment income | 130 | 57 | 29 |
| Total income | 22,199 | 26,886 | 18,604 |
| Interest on subordinated debt | 3,653 | 2,180 | 1,249 |
| Noninterest expense | 556 | 3 | 23 |
| Total expense | 4,209 | 2,183 | 1,272 |
| Income before income tax benefit and equity in undistributed net income of subsidiaries | 17,990 | 24,703 | 17,332 |
| Income tax benefit | (1,206) | (677) | (426) |
| Income before equity in undistributed net income of subsidiaries | 19,196 | 25,380 | 17,758 |
| Equity in undistributed net income of subsidiaries | 20,219 | 13,448 | 20,809 |
| Net income | <u>\$39,415</u> | <u>\$38,828</u> | <u>\$38,567</u> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

Note 22—Parent-Company Only Financial Information (Continued)

CONDENSED STATEMENTS OF CASH FLOWS

| | Year Ended December 31, | | |
|---|-------------------------|-----------|-----------|
| | 2006 | 2005 | 2004 |
| | (Dollars in thousands) | | |
| Operating activities: | | | |
| Net income | \$ 39,415 | \$ 38,828 | \$ 38,567 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed net income of subsidiaries | (20,219) | (13,448) | (20,809) |
| Stock-based compensation expense | 440 | — | — |
| Net (increase) decrease in other assets | 1,846 | (1,447) | (1,115) |
| Net increase in other liabilities | 274 | 43 | 540 |
| Other, net | (30) | (782) | (693) |
| Net cash provided by operating activities | 21,726 | 23,194 | 16,490 |
| Investing activities: | | | |
| Net cash paid due to acquisition | — | — | (18,403) |
| Capital contributions made to the subsidiaries | (15,000) | — | — |
| Net cash used in investing activities | (15,000) | — | (18,403) |
| Financing activities: | | | |
| Advances of long-term subordinated debt | — | 25,774 | 20,619 |
| Cash dividends | (21,779) | (20,738) | (18,575) |
| Repurchase of common stock | (5,502) | (9,972) | (3,815) |
| Proceeds from the exercise of stock options | 5,302 | 4,453 | 5,243 |
| Excess tax benefits from stock-based compensation | 948 | — | — |
| Other, net | (12) | (15) | (13) |
| Net cash provided by (used in) financing activities | (21,043) | (498) | 3,459 |
| Net increase (decrease) in cash | (14,317) | 22,696 | 1,546 |
| Cash and cash equivalents at beginning of year | 26,152 | 3,456 | 1,910 |
| Cash and cash equivalents at end of year | \$ 11,835 | \$ 26,152 | \$ 3,456 |

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors

Harleysville National Corporation

We have audited the accompanying consolidated balance sheets of Harleysville National Corporation (a Pennsylvania corporation) and its subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Harleysville National Corporation and subsidiaries as of December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12 and 14 to the consolidated financial statements, the Corporation has adopted Financial Accounting Standards Board Statement (FASB) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – An Amendment of FASB Statements No. 87, 88, 106 and 132(R)*, and FASB No. 123(R), *Share Based Payments* in 2006.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Harleysville National Corporation's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 2, 2007 expressed an unqualified opinion on management's assessment of the effectiveness of internal control over financial reporting and an unqualified opinion on the effectiveness of internal control over financial reporting.



Philadelphia, Pennsylvania
March 2, 2007

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

There have been no changes in the Corporation's internal control over financial reporting during the fourth quarter of 2006 that have materially affected, or reasonably likely to materially affect, the Corporation's internal control over financial reporting.

(i) Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15(d)-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and regulations and are operating in an effective manner.

(ii) Management's Report on Internal Control Over Financial Reporting

Management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, as a process designed by, or under the supervision of, the Corporation's principal executive and principal financial officers and effected by the Corporation's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Corporation;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Corporation's assets that could have a material effect of the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*. Management believes that, as of December 31, 2006, the Corporation's internal control over financial reporting was effective.

Item 9A. Controls and Procedures (Continued)

The Corporation's independent registered Public Accounting Firm has issued an audit report on management's assessment of the Corporation's internal control over financial reporting. This report appears herein in Item 9A, section iii.

(iii) Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

Board of Directors
Harleysville National Corporation

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Harleysville National Corporation (a Pennsylvania corporation) and its subsidiaries (collectively, the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Harleysville National Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Item 9A. Controls and Procedures (Continued)

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Harleysville National Corporation, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Harleysville National Corporation, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Harleysville National Corporation and its subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 and our report dated March 2, 2007 expressed an unqualified opinion on those financial statements.



Philadelphia, Pennsylvania
March 2, 2007

Item 9B. Other Information

None

Item 10. Directors, Executive Officers and Corporate Governance

The Corporation has a Code of Ethics for directors, officers and employees of the corporation. It is intended to promote honest and ethical conduct, full and accurate reporting, and compliance with laws as well as other matters.

The SEC requires disclosure concerning whether or not the Corporation has at least one "audit committee financial expert" on the Audit Committee. During 2006, Walter R. Bateman, II was the committee's independent financial expert, as defined by SEC regulations, and chaired the committee.

Additional information regarding directors, executive officers and corporate governance is included under the following captions in the Corporation's proxy statement relating to its 2007 annual meeting of shareholders (the "2007 Proxy Statement") and is incorporated herein by reference:

"Directors"
"Executive Officers"
"Corporate Governance"
"Meetings and Committees of the Board of Directors"
"Section 16(a) Beneficial Ownership Reporting Compliance"

In addition, the Corporation makes available on www.hnccbank.com (under "Investor Information—Corporate Governance") the following: 1) Audit Committee Charter, 2) Code of Ethics, 3) Whistleblower Policy, 4) Nominating Committee Charter and 5) Compensation Committee Charter.

Item 11. Executive Compensation

Information regarding executive compensation included under the following captions in the 2007 Proxy Statement is incorporated herein by reference:

"Directors"
"Meetings and Committees of the Board of Directors"
"Director Compensation"
"Compensation Discussion and Analysis"
"Compensation Committee Report"
"Compensation Committee Interlocks and Insider Participation"
"Executive Compensation"
"Potential Payments upon Termination or Change in Control"
"Executive Employment Agreements"

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Security ownership information of certain beneficial owners and management is included under the caption, "Beneficial Ownership," in the 2007 Proxy Statement is incorporated herein by reference.

The information required by this item concerning Equity Compensation Plan information is included in Part II, Item 5, "Equity Compensation Plan Information" of this Report on Form 10-K and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information included in Part II, Item 8, Footnote 5 "Loans" of this Report on Form 10-K is incorporated herein by reference.

Information included under the captions, "Related Party Transactions," "Corporate Governance," and "Meetings and Committees of the Board of Directors" in the 2007 Proxy Statement is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information included under the caption, "Independent Registered Public Accounting Firm," in the 2007 Proxy Statement is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this report (see Part II, Item 8, "Financial Statements and Supplementary Data"):

(1) Financial Statements:

(a) Consolidated Balance Sheets at December 31, 2006 and 2005

(b) Consolidated Statements of Income for the years ended December 31, 2006, 2005 and 2004

(c) Consolidated Statements of Shareholders' Equity for the years ended December 31, 2006, 2005 and 2004

(d) Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005 and 2004

(e) Notes to Consolidated Financial Statements

(f) Report of Independent Registered Public Accounting firm

(2) Financial Statement Schedules are not applicable

(3) The exhibits listed on the Exhibit Index at the end of this Report are filed with or incorporated as part of this Report (as indicated in connection with each Exhibit):

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HARLEYSVILLE NATIONAL CORPORATION

By: /s/ Demetra M. Takes
Demetra M. Takes,
Interim President, Chief Executive Officer and Director

Date: March 2, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| <u>Signature</u> | <u>Title</u> | <u>Date</u> |
|---|--|---------------|
| <u>/s/ WALTER R. BATEMAN, II</u> Walter R. Bateman, II | Director | March 2, 2007 |
| <u>/s/ LEEANN BERGEY</u> LeeAnn Bergey | Director | March 2, 2007 |
| <u>/s/ WALTER E. DALLER, JR.</u> Walter E. Daller, Jr. | Director | March 2, 2007 |
| <u>/s/ HAROLD A. HERR</u> Harold A. Herr | Director | March 2, 2007 |
| <u>/s/ THOMAS C. LEAMER</u> Thomas C. Leamer | Director | March 2, 2007 |
| <u>/s/ STEPHANIE S. MITCHELL</u> Stephanie S. Mitchell | Director | March 2, 2007 |
| <u>/s/ A. ROSS MYERS</u> A. Ross Myers | Director | March 2, 2007 |
| <u>/s/ GEORGE S. RAPP</u> George S. Rapp | Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer) | March 2, 2007 |
| <u>/s/ DEMETRA M. TAKES</u> Demetra M. Takes | Interim President, Chief Executive Officer and Director | March 2, 2007 |
| <u>/s/ JAMES A. WIMMER</u> James A. Wimmer | Director | March 2, 2007 |

EXHIBIT INDEX

| Exhibit No. | Description of Exhibits |
|----------------|---|
| (2.1) | Purchase Agreement, dated as of November 15, 2005, by and among Harleysville National Bank and Trust Company, Cornerstone Financial Consultants, Ltd., Cornerstone Advisors Asset Management, Inc., Cornerstone Institutional Investors, Inc., Cornerstone Management Resources, Inc., John R. Yaissle, Malcolm L. Cowen, II, and Thomas J. Scalici. The schedules and exhibits to the Purchase Agreement are listed at the end of the Purchase Agreement but have been omitted from the exhibit to Form 10-K. The Registrant agrees to supplementally furnish a copy of any omitted schedule or exhibit to the Securities and Exchange Commission upon request. (Incorporated by reference to Exhibit 2.1 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005, filed with the Commission on March 15, 2006.) |
| (2.2) | Branch Purchase Agreement and Deposit Assumption Agreement, dated as of July 26, 2006, by and among First National Community Bank as Buyer and Harleysville National Bank and Trust Company as Seller. (Incorporated by reference to Exhibit 2.2 to the Corporation's Quarterly Report filed on Form 10-Q, filed with the Commission on August 9, 2006.) The attachments, schedules and exhibits to the Branch Purchase and Deposit Assumption Agreement are listed at the end of the Branch Purchase and Deposit Assumption Agreement but have been omitted from the exhibit to the Form 10-Q. The Registrant agrees to supplementally furnish a copy of any omitted attachment, schedule or exhibit to the Securities and Exchange Commission upon request. |
| (3.1) | Harleysville National Corporation Amended and Restated Articles of Incorporation. (Incorporated by reference to Exhibit 3.1 to the Corporation's Registration Statement No. 333-111709 on Form S-4, as filed on January 5, 2004.) |
| (3.2) | Harleysville National Corporation Amended and Restated By-laws. (Incorporated by reference to Exhibit 3.1 to the Corporation's Current Report on Form 8-K, filed with the Commission on February 14, 2005.) |
| (10.1) | Harleysville National Corporation 1993 Stock Incentive Plan.** (Incorporated by reference to Exhibit 4.3 of Registrant's Registration Statement No. 33-69784 on Form S-8, filed with the Commission on October 1, 1993.) |
| (10.2) | Harleysville National Corporation Stock Bonus Plan.*** (Incorporated by reference to Exhibit 99A of Registrant's Registration Statement No. 333-17813 on Form S-8, filed with the Commission on December 13, 1996.) |
| (10.3) | Supplemental Executive Retirement Plan.* (Incorporated by reference to Exhibit 10.3 of Registrant's Annual Report in Form 10-K for the year ended December 31, 1997, filed with the Commission on March 27, 1998.) |
| (10.4) | Walter E. Daller, Jr., Chairman and former President and Chief Executive Officer's Employment Agreement dated October 26, 1998.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 25, 1999.) |
| (10.5) | Consulting Agreement and General Release dated November 12, 2004 between Walter E. Daller, Jr., Harleysville National Corporation and Harleysville National Bank and Trust Company.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on November 16, 2004.) |
| (10.6) | Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and Walter E. Daller, Jr.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.) |

**Exhibit
No.**

Description of Exhibits

- (10.7) Employment Agreement dated October 26, 1998 by and among Harleysville National Corporation, Harleysville National Bank and Trust Company and Demetra M. Takes, President and Chief Executive Officer of Harleysville National Bank and Trust Company.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 25, 1999.)
- (10.8) Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and Demetra M. Takes, President and Chief Executive Officer of Harleysville National Bank and Trust Company.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
- (10.9) Harleysville National Corporation 1998 Stock Incentive Plan.** (Incorporated by reference to Registrant's Registration Statement No. 333-79971 on Form S-8, filed with the Commission on June 4, 1999.)
- (10.10) Harleysville National Corporation 1998 Independent Directors Stock Option Plan, as amended and restated effective February 8, 2001.** (Incorporated by reference to Appendix "A" of Registrant's Definitive Proxy Statement, filed with the Commission on March 9, 2001.)
- (10.11) Supplemental Executive Retirement Benefit Agreement dated February 23, 2004 between Michael B. High, Executive Vice President and former Chief Financial Officer, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q, filed with the Commission on May 10, 2004.)
- (10.12) Employment Agreement effective April 1, 2005 between Michael B. High, Executive Vice President and Chief Operating Officer of the Corporation, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on November 16, 2004.)
- (10.13) Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and Michael B. High, Executive Vice President and Chief Operating Officer of the Corporation.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
- (10.14) Employment Agreement dated March 9, 2004 between Mikkalya Murray, Executive Vice President and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q, filed with the Commission on May 10, 2004.)
- (10.15) Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and Mikkalya Murray, Executive Vice President.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
- (10.16) Harleysville National Corporation 2004 Omnibus Stock Incentive Plan, as amended and restated effective November 9, 2006.** (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on November 15, 2006.)
- (10.17) Employment Agreement dated August 23, 2004 between James F. McGowan, Jr., Executive Vice President & Chief Credit Officer and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on August 25, 2004.)

**Exhibit
No.**

Description of Exhibits

- (10.18) Supplemental Executive Retirement Benefit Agreement dated August 23, 2004 between James F. McGowan, Jr., Executive Vice President & Chief Credit Officer, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on August 25, 2004.)
- (10.19) Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and James F. McGowan, Jr., Executive Vice President & Chief Credit Officer.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
- (10.20) Employment Agreement dated September 27, 2004 between John Eisele, Executive Vice President & President of Millennium Wealth Management and Private Banking, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on September 29, 2004.)
- (10.21) Supplemental Executive Retirement Benefit Agreement dated September 27, 2004 between John Eisele, Executive Vice President & President of Millennium Wealth Management and Private Banking, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on September 29, 2004.)
- (10.22) Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and John Eisele, Executive Vice President & President of Millennium Wealth Management and Private Banking.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
- (10.23) Employment Agreement effective January 1, 2005 between Gregg J. Wagner, President and Chief Executive Officer of the Corporation, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on November 16, 2004.)
- (10.24) Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and Gregg J. Wagner, the current President and Chief Executive Officer of the Corporation.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
- (10.25) Complete Settlement Agreement and General Release dated November 29, 2006 and effective December 8, 2006 between Gregg J. Wagner and Harleysville National Corporation, Harleysville National Bank and Trust Company and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on December 13, 2006.)
- (10.26) Employment Agreement dated May 18, 2005, between George S. Rapp, Senior Vice President and Chief Financial Officer, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on May 20, 2005.)
- (10.27) Stock Purchase Agreement dated June 30, 2005, between David R. Kotok & Associates, Inc., Harleysville National Corporation and Harleysville National Bank and Trust Company. (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on July 1, 2005.)
- (10.28) Amended and Restated Declaration of Trust for HNC Statutory Trust III by and among Wilmington Trust Company, as Institutional Trustee and Delaware Trustee, Harleysville National Corporation, as Sponsor, and the Administrators named therein, dated as of September 28, 2005. (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q/A, filed with the Commission on November 9, 2005.)

**Exhibit
No.**

Description of Exhibits

- (10.29) Indenture between Harleysville National Corporation, as Issuer, and Wilmington Trust Company, as Trustee, for Fixed/Floating Rate Junior Subordinated Debt Securities, dated as of September 28, 2005. (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q/A, filed with the Commission on November, 9, 2005.)
- (10.30) Guarantee Agreement between Harleysville National Corporation and Wilmington Trust Company, dated as of September 28, 2005. (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q/A, filed with the Commission on November, 9, 2005.)
- (10.31) Employment Agreement effective July 12, 2006 between Lewis C. Cyr, Chief Lending Officer of the Corporation, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on July 12, 2006.)
- (11) Computation of Earnings per Common Share, incorporated by reference to Part II, Item 8, Footnote 15, "Earnings Per Share," of this Report on Form 10-K
- (21) Subsidiaries of Registrant
- (23) Consent of Grant Thornton LLP, Independent Registered Public Accounting firm
- (31.1) Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
- (31.2) Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
- (32.1) Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.
- (32.2) Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

* Management contract or compensatory plan arrangement.

** Shareholder approved compensatory plan pursuant to which the Registrant's Common Stock may be issued to employees of the Corporation.

*** Non-shareholder approved compensatory plan pursuant to which the Registrant's Common Stock may be issued to employees of the Corporation.

HARLEYSVILLE NATIONAL CORPORATION
SUBSIDIARIES

| <u>Name</u> | <u>Jurisdiction of Incorporation</u> |
|---|--------------------------------------|
| Harleysville National Bank and Trust Company..... | Pennsylvania |
| Cornerstone Advisors Asset Management, Inc..... | Pennsylvania |
| Cornerstone Financial Consultants, Ltd..... | Pennsylvania |
| Cornerstone Institutional Investors, Inc..... | Pennsylvania |
| HNB Auto Sales, LLC..... | Pennsylvania |
| HNC Insurance Agency, Inc..... | Pennsylvania |
| Harleysville Management Services, LLC..... | Pennsylvania |
| HNC Financial Company..... | Delaware |
| HNC Reinsurance Company..... | Arizona |
| Harleysville Statutory Trust I..... | Connecticut |
| HNC Statutory Trust II..... | Delaware |
| HNC Statutory Trust III..... | Delaware |

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have issued our reports dated March 2, 2007, (which includes an explanatory paragraph relating to the application of Statement of Financial Accounting Standards Nos. 123(R) and 158 as of December 31, 2006) accompanying the consolidated financial statements and management's assessment of the effectiveness of internal control over financial reporting included in the 2006 Annual Report of Harleysville National Corporation and subsidiaries on Form 10-K for the year ended December 31, 2006. We hereby consent to the incorporation by reference of said reports in the Registration Statements of Harleysville National Corporation on Forms S-8 (File No. 33-69784, effective October 1, 1993, File No. 333-17813, effective December 13, 1996; File No. 333-79971, effective June 4, 1999, and File No. 333-79973, effective June 4, 1999, File No. 333-116183, effective June 4, 2004, File No. 333-139579, effective December 21, 2006).



Philadelphia, Pennsylvania
March 2, 2007

CERTIFICATION

I, Demetra M. Takes, Interim President, Chief Executive Officer and Director, certify, that:

1. I have reviewed this annual report on Form 10-K of Harleysville National Corporation.
2. Based on my knowledge, the annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report.
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 2, 2007

By:



Interim President, Chief Executive Officer and Director
Harleysville National Corporation

CERTIFICATION

I, George S. Rapp, Executive Vice President and Chief Financial Officer, certify, that:

1. I have reviewed this annual report on Form 10-K of Harleysville National Corporation.
2. Based on my knowledge, the annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report.
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonable likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 2, 2007

By:




Executive Vice President and Chief Financial Officer
Harleysville National Corporation

**HARLEYSVILLE NATIONAL CORPORATION
CERTIFICATION
PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350**

In connection with the Harleysville National Corporation Annual Report on Form 10-K for the period ending December 31, 2006, as filed with the Securities and Exchange Commission (the "Report"), I, Demetra M. Takes, Interim President, Chief Executive Officer and Director, certify, pursuant to 18 U.S.C. Section 1350, as added Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. To my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

By:



*Interim President, Chief Executive Officer and
Director*

Harleysville National Corporation

Date: March 2, 2007

**HARLEYSVILLE NATIONAL CORPORATION
CERTIFICATION
PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350**

In connection with the Harleysville National Corporation Annual Report on Form 10-K for the period ending December 31, 2006, as filed with the Securities and Exchange Commission (the "Report"), I, George S. Rapp, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as added Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. To my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

By:



*Executive Vice President and
Chief Financial Officer*
Harleysville National Corporation

Date: March 2, 2007



Harleysville

NATIONAL CORPORATION

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON APRIL 24, 2007

TO THE SHAREHOLDERS OF HARLEYSVILLE NATIONAL CORPORATION:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Shareholders of Harleysville National Corporation will be held at 9:30 a.m., prevailing time, on Tuesday, April 24, 2007, at Presidential Caterers, 2910 DeKalb Pike, Norristown, Pennsylvania 19401, for the following purposes:

1. To elect two Class A Directors: Harold A. Herr and Stephanie S. Mitchell each for a term of 4 years;
2. To transact any other business properly brought before the Annual Meeting and at any adjournment or postponement of the meeting.

In accordance with the by-laws of the corporation and action of the Board of Directors, only those shareholders of record at the close of business on March 7, 2007, will be entitled to notice of and to vote at the Annual Meeting and any adjournment or postponement thereof.

A copy of the corporation's Annual Report for the fiscal year ended December 31, 2006, accompanies this Notice. Copies of the corporation's Annual Report for the 2005 fiscal year may be obtained at no cost by contacting Liz Chemnitz, Senior Vice President and Assistant Secretary of the corporation, Harleysville National Corporation, 483 Main Street, P.O. Box 195, Harleysville, Pennsylvania 19438-0195, telephone (215) 256-8851.

Your vote is important regardless of the number of shares that you own. Please sign, date and return the enclosed proxy card, or follow the instructions provided for voting via telephone or the internet. Giving your proxy does not affect your right to vote in person if you attend the meeting and give written notice to the Secretary of the corporation.

BY ORDER OF THE BOARD OF DIRECTORS,

Walter E. Daller, Jr.
Chairman of the Board

March 22, 2007
Harleysville, Pennsylvania

PROXY STATEMENT

Dated and to be mailed March 22, 2007

HARLEYSVILLE NATIONAL CORPORATION
483 MAIN STREET
HARLEYSVILLE, PENNSYLVANIA 19438-0195
(215) 256-8851

ANNUAL MEETING OF SHAREHOLDERS
TO BE HELD ON APRIL 24, 2007

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Questions and Answers

What am I voting on?

- To elect 2 Class A Directors:
 - Harold A. Herr
 - Stephanie S. Mitchell

How does discretionary authority apply?

If you sign your proxy card and do not make any selections, you give authority to Louis P. Spinelli, Executive Vice President, and Tracie A. Young, Senior Vice President and Chief Compliance Officer, to vote on the proposals and any other matters that may arise at the meeting.

Is my vote confidential?

Yes. Only the inspector, ADP Investor Communication Services, Shareholder Services, and certain employees have access to your card. All comments remain confidential unless you ask that your name be disclosed.

Who is entitled to vote?

Shareholders on the record date, which is the close of business on March 7, 2007.

How many votes do I have?

Each share of common stock is entitled to one vote.

How do I vote?

You may vote by completing and returning the enclosed proxy card or by voting in person at the meeting. In addition, you may be able to vote via telephone or through the Internet, as described under Voting Methods below.

You have the right to vote and, if desired, to revoke your proxy at any time before the Annual Meeting:

- by giving written notice of revocation to the Secretary of Harleysville National Corporation at 483 Main Street, P.O. Box 195, Harleysville, PA 19438-0195;
- by executing a later-dated proxy and giving written notice thereof to the Secretary of the corporation;
- or
- by voting in person after giving written notice to the Secretary of the corporation.

Should you have any questions, please call Harleysville National Corporation, Shareholder Services, 800-423-3955 ext. 62305.

Voting Methods

Voting by Proxy. You may vote by completing and returning the enclosed proxy. Your proxy will be voted in accordance with your instructions. If you do not specify a choice on one of the proposals described in this proxy statement, your proxy will be voted as recommended by the Board of Directors.

ON YOUR PROXY CARD:

- Mark your selections
- Date and sign your name exactly as it appears on your card
- Mail to ADP Investor Communication Services, in the return envelope

Questions and Answers (cont'd)

Voting by Telephone or Internet. You may vote via the telephone or electronically through the Internet by following the instructions included with your proxy card.

Voting in Person. If you attend the meeting, you may deliver your completed proxy card in person or you may vote by completing a ballot which will be available at the meeting.

The last vote you submit chronologically (by any means) will supersede your prior vote(s). If you vote via telephone or the Internet and later decide to attend the annual meeting, you may cancel your previous vote and vote in person at the meeting.

What is the total number of HNC shares outstanding?

As of March 7, 2007, 28,967,135 shares of the corporation's common stock were issued and outstanding. No shares of preferred stock are outstanding. The corporation is currently authorized to issue 75,000,000 shares of common stock, par value \$1.00 per share, and 8,000,000 shares of series preferred stock, par value \$1.00 per share.

What constitutes a quorum?

A majority of the outstanding shares constitutes a quorum if present or represented by proxy at the Annual Meeting. If you vote by proxy card, you will be considered part of the quorum.

How does a shareholder communicate with the corporation's Board of Directors?

The Board of Directors does not have a formal process for shareholders to send communications to the Board. Due to the infrequency of shareholder communications to the Board of Directors, the Board does not believe that a formal process is necessary. However, only written communications received by the corporation from shareholders are shared with the full Board no later than the next regularly scheduled Board meeting.

When are the shareholder proposals due for the Year 2008 Annual Meeting?

If a shareholder wants us to include a proposal in our proxy statement for presentation at our 2008 Annual Meeting of shareholders, the proposal must be submitted in writing by Friday, November 23, 2007, to the Secretary of Harleysville National Corporation at 483 Main Street, P.O. Box 195, Harleysville, PA 19438-0195.

How does a shareholder nominate a director of Harleysville National Corporation?

Under our by-laws, nominations for director may be made only by the Board of Directors, or the Nominating Committee of the Board of Directors, or by a shareholder of record entitled to vote. In order for a shareholder to make a nomination, the shareholder must provide a notice with information and materials required by the by-laws to our Corporate Secretary not less than 45 days prior to the first anniversary of the record date of the preceding year's Annual Meeting. For our Annual Meeting in the year 2008, we must receive this notice on or before January 23, 2008. You can obtain a copy of the full text of the by-law provision by writing to the Secretary of Harleysville National Corporation at 483 Main Street, P.O. Box 195, Harleysville, PA 19438-0195.

Who is responsible for the solicitation expenses?

ADP Investor Communication Services will assist in the distribution of proxy materials and solicitation of votes. The corporation is responsible for expenses related to distribution of proxy materials and solicitation of votes and will reimburse ADP Investor Communication Services, stockbrokers and other custodians, nominees and fiduciaries for their reasonable out-of-pocket expenses for forwarding proxy and solicitation material to the owners of the corporation's common stock.

Proxy Statement

This Proxy Statement is furnished as part of the solicitation of proxies by the Board of Directors of Harleysville National Corporation for use at the Annual Meeting of Shareholders to be held at 9:30 a.m., prevailing time, on Tuesday, April 24, 2007, at Presidential Caterers, 2910 DeKalb Pike, Norristown, Pennsylvania 19401. This Proxy Statement and the form of Proxy are first being sent to Shareholders on approximately March 22, 2007.

Corporate Governance

The corporation operates within a comprehensive plan of corporate governance for the purpose of defining responsibilities, setting high standards of professional and personal conduct and assuring compliance with such responsibilities and standards. The corporation regularly monitors developments in the area of corporate governance. The Nominating and Corporate Governance Committee Charter is available on the Investor Information/Corporate Governance page of our website at www.hnccbank.com.

During 2006, a majority of the members of the corporation's Board of Directors are independent within the meaning of the independence standards of the NASDAQ Stock Market, Inc., as currently in effect: namely, Walter R. Bateman, II, LeeAnn B. Bergey, Harold A. Herr, Thomas C. Leamer, Stephanie S. Mitchell, A. Ross Myers and James A. Wimmer. Each of the nominees for director at this year's annual meeting is independent within these standards.

In determining the directors' independence, the board of directors considered loan transactions between the Bank and the directors, their family members and businesses with whom they are associated; as well as any contributions made to non-profit organizations with whom the directors are associated.

The table below includes a description of other categories or types of transactions, relationships or arrangements considered by the board (in addition to those listed above) in reaching its determination that the directors are independent.

| Name | Independent | Other Transactions/Relationships/Arrangements |
|--------------|-------------|--|
| Mr. Bateman | Yes | |
| Ms. Bergey | Yes | Payments to associated business for banking-related services |
| Mr. Herr | Yes | |
| Dr. Leamer | Yes | |
| Ms. Mitchell | Yes | |
| Mr. Myers | Yes | |
| Mr. Wimmer | Yes | Payments for legal services primarily related to debt collection and mortgage foreclosures |

In each case, the board determined that none of the transactions above impaired the independence of the director. For more information regarding related party transactions, please refer to the corporation's disclosures on page 32.

Code of Ethics

We have also adopted a Code of Ethics for directors, officers and employees of the corporation. It is intended to promote honest and ethical conduct, full and accurate reporting and compliance with laws as well as other matters. The Code of Ethics is available on the Investor Information/Corporate Governance page of our website at www.hnccbank.com.

Proposal No: 1

Election of Class A Directors

Nominees for election this year are:

- Harold A. Herr – director since 1987
- Stephanie S. Mitchell – director since 2002

Each nominee has consented to serve a 4-year term and until their successors are qualified and elected.

Directors are elected by a plurality of votes cast at the meeting. "Plurality" means that the nominees receiving the largest number of votes cast are elected as directors up to the maximum number of directors to be elected at the meeting. At our meeting, the maximum number of directors to be elected is two.

The by-laws of Harleysville National Corporation provide that the Board of Directors will not have less than 5 members or more than 25 members. The Board of Directors is divided into 4 classes. Each class is elected for a 4-year term. The Board of Directors has authority to fix the number of directors in each class and the authority to change that number at any time. No person may be elected to serve as a director who is not of legal age. No person over 72 may serve as a director. The Board of Directors has fixed the number of Board members at 9, with 2 directors in Class A, 3 directors in each of Classes B and D, and 1 director in Class C. Section 11.1 of the by-laws requires that a majority of the remaining members of the Board of Directors select and appoint directors to fill vacancies, even if the number of remaining members is less than a quorum. Each person who is appointed in this manner serves as a director until the expiration of the term of office of the class of directors to which he or she was appointed.

The Board of Directors recommends a vote **FOR** the election of these Class A Directors.

Principal Owners

No business group or person owns more than 5% of the corporation's total outstanding shares of common stock as of March 7, 2007.

Beneficial Ownership by Directors, Officers and Nominees

The following table indicates the amount and percentage of the corporation's total outstanding shares of common stock beneficially owned by each named executive officer, director and nominee for director and by all directors and officers of the corporation and its subsidiaries as a group, as of March 7, 2007.

None of the corporation's directors, nominees for director, or named executive officers have pledged as security any of their HNC common stock.

| <u>Name</u> | <u>Common Stock Beneficially Owned</u> | <u>Right to Acquire within 60 days of March 7, 2007 (1)</u> | <u>Total (2)</u> | <u>Percent of Class</u> |
|---------------------------|--|---|------------------|-----------------------------|
| Directors | | | | |
| Walter R. Bateman, II (3) | 3,711 | 19,729 | 23,440 | * |
| LeeAnn B. Bergey (4) | 9,288 | 45,812 | 55,100 | * |
| Walter E. Daller, Jr. (5) | 537,608 | 287,753 | 825,361 | 2.75 % |
| Harold A. Herr (6) | 39,648 | 52,613 | 92,261 | * |
| Thomas C. Leamer (7) | 143 | 13,651 | 13,794 | * |
| Stephanie S. Mitchell (8) | 100,733 | 13,651 | 114,384 | * |
| A. Ross Myers (9) | 54 | -0- | 54 | * |
| Demetra M. Takes (10) | 60,022 | 9,627 | 69,649 | * |
| James A. Wimmer (11) | 817,087 | 27,481 | 844,568 | 2.82 % |

Beneficial Ownership by Directors, Officers and Nominees (continued)

| <u>Name</u> | <u>Common Stock Beneficially Owned</u> | <u>Right to Acquire within 60 days of March 7, 2007 (1)</u> | <u>Total (2)</u> | <u>Percent of Class</u> |
|--|--|---|------------------|-----------------------------|
| Other Named Executive Officers | | | | |
| George S. Rapp (12) | 151 | 1,176 | 1,327 | * |
| Michael B. High (13) | 7,237 | 12,562 | 19,799 | * |
| John W. Eisele (14) | 13,919 | -0- | 13,919 | * |
| James F. McGowan (15) | 3,285 | 4,540 | 7,825 | * |
| Mikkalya W. Murray (16) | 21,563 | -0- | 21,563 | * |
| Gregg J. Wagner (17) | 26,335 | -0- | 26,335 | * |
| All Directors and Executive Officers as a Group (15 persons) | 1,594,912 | 491,066 | 2,085,978 | 7.0 % (18) |

*Less than one percent (1%) unless otherwise indicated.

- (1) Shares that may be acquired upon the exercise of vested stock options through May 6, 2007.
- (2) Includes shares for which the named person:
 - has sole voting and investment power,
 - has shared voting and investment power with a spouse.
- (3) Class B Director whose term expires in 2008. Ownership includes 546 shares held solely by Mr. Bateman's spouse.
- (4) Class B Director whose term expires in 2008. 8,393 shares held solely by Ms. Bergey and 895 held jointly with her spouse.
- (5) Class D Director whose term expires in 2010. Ownership includes the following:
 - 41,329 shares held solely by Mr. Daller's spouse, and
 - 73,583 vested stock options held by an Irrevocable Trust for the benefit of Mr. Daller's 3 children.
- (6) Class A Director whose term expires in 2007 and nominee for Class A Director whose term will expire in 2011. Shares held solely by Mr. Herr.
- (7) Class D Director whose term expires in 2010. Shares held solely by Dr. Leamer.
- (8) Class A Director whose term expires in 2007 and nominee for Class A Director whose term will expire in 2011.

Ownership includes the following:

 - 16,100 shares held by Ms. Mitchell's spouse,
 - 43,410 shares held by her company, and
 - 3,180 shares held by a trust for which Ms. Mitchell acts as Co-Trustee.
- (9) Class D Director whose term expires in 2010. Shares held solely by Mr. Myers.
- (10) Class B Director whose term expires in 2008. Ownership includes 5,342 shares held solely by parent living in Ms. Takes' home.
- (11) Class C Director whose term expires in 2009. Ownership includes the following:
 - 619,696 shares held solely by Mr. Wimmer's spouse, and
 - 15,887 shares held by a trust for which Mr. Wimmer acts as Co-Trustee.
- (12) Executive Vice President and Chief Financial Officer. Shares held solely by Mr. Rapp.
- (13) Executive Vice President and Chief Operating Officer. Shares held solely by Mr. High.
- (14) Executive Vice President and President of Millennium Wealth Management and Private Banking. Shares held solely by Mr. Eisele.
- (15) Executive Vice President and Chief Credit Officer. Shares held solely by Mr. McGowan.
- (16) Shares held solely by Ms. Murray, who ceased to be an executive officer prior to January 1, 2006 and who resigned effective September 1, 2006.
- (17) Shares held solely by Mr. Wagner, who left the company effective September 26, 2006.
- (18) The percent of class assumes the exercise of all outstanding options issued to directors, employee directors, and officers and, therefore, on a *pro forma* basis, 29,992,673 shares of common stock outstanding.

DIRECTORS

Two directors will be elected at the Annual Meeting to serve as Class A Directors each to serve for a 4-year term expiring in the year 2011.

| <u>Name</u> | <u>Age</u> | <u>Principal Occupation for Past Five Years and Position Held with the Corporation</u> | <u>Director of Corporation Since</u> |
|---|------------|--|--|
| Class A Directors to Serve Until 2007 (Nominees for Class A Director To Serve Until 2011) | | | |
| Harold A. Herr | 59 | Partner – Albert S. Herr & Sons; Real Estate Development; Director of Harleysville and Harleysville National Bank | 1987 |
| Stephanie S. Mitchell | 58 | Secretary, Director – R. C. Smith Industries, Inc; Secretary/Treasurer, Director – Cole Candy & Tobacco Co., Inc.; Director of Harleysville and Harleysville National Bank; Member of HNB Western Regional Advisory Board | 2002 |
| Class B Directors to Serve Until 2008 | | | |
| Demetra M. Takes | 56 | Interim President & Chief Executive Officer and Director of Harleysville; President & Chief Executive Officer and Director of Harleysville National Bank; Member of HNB's Western Regional & Northern Regional Advisory Boards | 2005 |
| Walter R. Bateman, II | 59 | Chief Executive Officer – Polestar, Inc; Retired Chairman & Chief Executive Officer – Harleysville Group, Inc. & Harleysville Mutual Insurance Company; Director of Harleysville and Harleysville National Bank | 2002 |
| LeeAnn B. Bergey | 53 | Chief Executive Officer – BTG Holdings, LLC; Director of Harleysville and Harleysville National Bank | 1999 |
| Class C Directors to Serve Until 2009 | | | |
| James A. Wimmer | 66 | Attorney-at-Law – Philip & Wimmer; Director of Harleysville and Harleysville National Bank; Member of HNB Northern Regional Advisory Board | 2000 |
| Class D Directors to Serve Until 2010 | | | |
| Walter E. Daller, Jr. | 67 | Chairman of Harleysville and Harleysville National Bank; Member of HNB's Western Regional & Northern Regional Advisory Boards; Retired Chief Executive Officer of Harleysville and Harleysville National Bank; Chairman, President and Chief Executive Officer of Harleysville and Chairman of Harleysville National Bank from 1981 to 2004 | 1977 |
| Thomas C. Leamer | 65 | President – Delaware Valley College; Director of Harleysville and Harleysville National Bank | 2003 |
| A. Ross Myers | 57 | Chief Executive Officer, American Infrastructure; Director of Harleysville and Harleysville National Bank | 2006 |

Meetings and Committees of the Board of Directors

| Board Member | Attended 2006 Annual Meeting | Corporate Board | Audit | Compensation | Executive | Nominating/Corporate Governance |
|-----------------------|------------------------------|-----------------|-------|--------------|-----------|---------------------------------|
| W. R. Bateman, II | ✓ | ✓ | ✓ | | | |
| L. B. Bergey | ✓ | ✓ | ✓ | | | |
| W. E. Daller, Jr. | ✓ | ✓ | | | | |
| H. A. Herr | ✓ | ✓ | | | | |
| T. C. Leamer | ✓ | ✓ | ✓ | | | |
| S. S. Mitchell | ✓ | ✓ | | | | |
| A. R. Myers (1) | ✓ | ✓ | | | | |
| D. M. Takes | ✓ | ✓ | | | | |
| J. A. Wimmer (2) | ✓ | ✓ | | | | |
| Meetings Held in 2006 | | 9 | 9 | 14 | 7 | 12 |

(1) Appointment effective May 11, 2006.

(2) Appointed to Audit & Executive committees effective October 12, 2006.

• Audit Committee:

The Audit Committee held 9 meetings during fiscal year 2006. All members of the committee are non-executive, independent (as independence is currently defined in Rule 4200(a)(15) of the NASD listing standards and Section 10A of the Securities Exchange Act of 1934, as amended) and possess the required level of financial literacy. Each is free from any relationship that would interfere with the exercise of his or her independent judgment.

During 2006, Walter R. Bateman, II was the committee's financial expert, as defined by SEC regulations, and chaired the committee. Other members of the committee include independent directors LeeAnn B. Bergey, Thomas C. Leamer and James A. Wimmer.

The Audit Committee operates under a formal charter that governs its duties and conduct. The Audit Committee Charter is available on the Investor Information/Corporate Governance page of our website at www.hncbank.com. Grant Thornton LLP, the corporation's registered public accounting firm, reports directly to the Audit Committee.

The Audit Committee, consistent with the Sarbanes-Oxley Act of 2002 and the rules adopted thereunder, meets with management and the auditors prior to the filing of officers' certifications with the SEC to receive information concerning, among other things, significant deficiencies in the design or operation of internal controls.

The Audit Committee has also adopted a Whistleblower Policy to enable confidential and anonymous reporting to the Audit Committee. The policy is also available on the Investor Information/Corporate Governance page of our website at www.hncbank.com.

• Compensation Committee:

The Compensation Committee administers executive compensation programs, policies and practices, and acts in an advisory role on employee compensation. All members of the committee are independent (as independence is currently defined in Rule 4200(a)(15) of the NASD listing standards.) The members are Harold A. Herr, Chairman, Stephanie S. Mitchell and A. Ross Myers. The committee met 14 times during 2006.

The Compensation Committee operates under a formal charter that governs its duties and conduct. The Compensation Committee Charter is available on the Investor Information/Corporate Governance page of our website at www.hncbank.com.

At least annually, the Compensation Committee conducts a comprehensive review of the corporation's executive compensation program structure and the specific provisions for each of our highly compensated

employees, including the Named Executive Officers. It also conducts a similar review of compensation provisions for positions on the Board of Directors.

The Compensation Committee relies upon an external consultant for information about current industry practices and programming trends, and solicits performance information on executives from the Chief Executive Officer. (The committee seeks input from other Board members on the performance of the CEO.)

After reviewing the submissions of its consultant, the CEO and other Directors, the Compensation Committee independently formulates its recommendations on changes to the executive and director compensation program structures and/or the balance among the programs' elements. It also makes recommendations on adjustments to individual executive's compensation, including: salary increases, annual incentive awards, longer-term incentive awards--usually in the form of stock options or restricted stock, special benefit provisions, perquisites and employment arrangements. These recommendations are submitted to the full Board for approval.

During the course of a year, the Compensation Committee continues to consider possible changes to executive and director compensation practices based on changing industry trends and internal corporate circumstances and objectives. It may also review and approve special compensation awards and adjustments for incumbent executives and compensation arrangements for new executives joining the organization.

- **Executive Committee:**

The Executive Committee is authorized to act on behalf of the Board during intervals between meetings of the Board. The Executive Committee can respond quickly to time-sensitive business and legal matters when they arise. Members of the Executive Committee are Walter E. Daller, Jr., Chairman, LeeAnn B. Bergéy, Harold A. Herr, Stephanie S. Mitchell and James A. Wimmer. The committee met 7 times during 2006.

- **Nominating and Corporate Governance Committee:**

The principal duties of the committee are to provide continuing assistance to the Board of Directors regarding matters relating to governance, performance, and composition of the Board. To fulfill its responsibilities and duties, the committee identifies qualified individuals to become Board members, recommends nominees to the Board to fill vacant Board seats, develops and recommends corporate governance guidelines to the Board, periodically reviews and assesses the Board and management performance and annually reviews and assesses its performance and charter. The committee has no formal process for considering director candidates recommended by shareholders due to the infrequency of nominations, but its policy is to give due consideration to any and all candidates.

The Nominating and Corporate Governance Committee operates under a formal charter that governs its duties and standards of performance. The charter appears on the Investor Information/Corporate Governance page of our website at www.hncbank.com.

Members of the committee during 2006 included Thomas C. Leamer, Chairman, LeeAnn B. Bergéy, Harold A. Herr and James A. Wimmer, each of whom is a non-employee director. All members of the committee are independent (as independence is currently defined in Rule 4200(a)(15) of the NASD listing standards.) The committee met 12 times during 2006.

The members of the Board of Directors of the corporation also serve as the members of the Board of Directors of Harleysville National Bank. During 2006, the corporation held 7 regular and 2 special Board meetings, the annual meeting and the annual reorganization meeting. All of the directors attended at least 75% of the meetings of the Boards of Directors of the corporation and of the committees of which they were members.

The corporation has no specific policy requiring directors to attend the Annual Meeting of Shareholders. However, criteria for determining the percentage of all meetings attended by each director include their attendance at the annual meeting. Active members of the Board of Directors, at the time, were present at the 2006 Annual Meeting of Shareholders, with the exception of Ms. Mitchell.

Director Compensation

In 2006, each director who was not an employee of the corporation earned or was paid certain fees, including annual retainer fees, committee and/or chairmanship fees, and meeting fees. Directors were not compensated for committee meetings of less than 15 minutes in duration or for committee meetings held prior to a Board meeting. In 2006, Directors of Harleysville received \$279,915, in the aggregate.

This compensation included the following:

- \$1,650 for each Board meeting attended,
- \$825 for Annual Meeting attendance,
- \$500 for each Board committee meeting attended, except for Audit Committee which receives \$600,
- an annual retainer of \$15,000, and
- an annual retainer of \$2,500 to committee chairpersons, except for Audit Committee which receives \$3,000.

Directors Emeriti are generally not eligible to receive annual retainers, bonuses, stock option awards or sit on committees of the Board. They receive half of the prevailing board fee for each board meeting attended. It should be noted, however, that Director Emeritus, William M. Yocum, has been appointed to a special Search Committee for the purpose of finding a permanent replacement for the President and Chief Executive Officer, subsequent to the departure of Mr. Gregg J. Wagner. Mr. Yocum receives the full prevailing committee fee for his attendance in this regard.

Directors who are also salaried officers of Harleysville or Harleysville subsidiaries do not receive any fees for Board or committee meetings.

The following table provides information about the compensation of directors during 2006.

Director Compensation Table

| Name | Fees Earned or Paid in Cash (\$) | Option Awards \$(1)(2) | Change in Pension Value and Nonqualified Deferred Compensation Earnings \$(3) | All Other Compensation \$(4) | Total \$(5) |
|-----------------------|----------------------------------|------------------------|---|------------------------------|-------------|
| Walter R. Bateman, II | \$37,575 | \$7,699 | \$8,971 | | \$ 54,245 |
| LeeAnn B. Bergey | \$36,075 | \$7,699 | | | \$ 43,774 |
| Walter E. Daller, Jr. | \$34,275 | \$7,699 | | \$508,843 (4) | \$550,817 |
| Harold A. Herr | \$36,975 | \$7,699 | | | \$ 44,674 |
| Thomas C. Leamer | \$36,240 | \$7,699 | | | \$ 43,939 |
| Stephanie S. Mitchell | \$32,850 (7) | \$7,699 | | | \$ 40,549 |
| A. Ross Myers | \$12,050 | -0- | | | \$ 12,050 |
| James A. Wimmer | \$36,075 (8) | \$7,699 | | \$62,672 (5) | \$106,446 |
| William M. Yocum | \$ 9,625 | \$7,699 | | \$49,083 (6) | \$ 66,407 |

- (1) 1,575 non-qualified stock options were granted to each active Harleysville non-employee director on January 3, 2006; with 750 options granted under 1998 Independent Directors Stock Option Plan and 825 options granted under 2004 Omnibus Stock Incentive Plan. The value of each award is equal to the amount recognized for financial reporting purposes during 2006 and represents the full grant date fair value of each award. The fair value of all non-employee director grants is recognized in the year of grant. Therefore, there is no fair value associated with grants awarded prior to 2006.
- (2) The aggregate number of outstanding option awards held by each non-employee director at December 31, 2006, is as follows: Bateman - 19,729; Bergey - 45,812; Daller - 287,753; Herr - 52,613; Leamer - 13,651; Mitchell - 13,651; Wimmer - 27,481; and Yocum - 40,047. All outstanding options awarded to non-employee directors, with the exception of Mr. Daller, were annual grants between 1999 and 2006. All grants were made under substantially the same terms, with 100% vesting after 6 months from date of grant and expiration 10 years from date of grant. The grant prices were based on either of the following criteria: (i) the average of the high and low prices of the corporation's common stock on the date of grant; (ii) the closing price of the corporation's common stock on the date of grant; or (iii) the closing price of the corporation's common stock on the last trading day immediately preceding the date of grant. With the exception of the January 3, 2006 grant, as awarded to all non-employee directors, Mr. Daller's outstanding option grants were awarded pursuant to his employment with the corporation; all are fully vested and will expire 10 years from their respective dates of grant.
- (3) The sum of (i) the aggregate change in the actuarial present value of the director's benefit under all defined benefit and actuarial pension plans from the pension plan measurement date used for financial statement reporting purposes with respect to Harleysville's audited financial statements for 2005 to the pension plan measurement date used for financial statement reporting purposes with respect to Harleysville's audited financial statements for 2006 and (ii) above-market or preferential earnings on non-tax-qualified deferred compensation.

- (4) Includes \$107,000 consulting fees paid under terms of Mr. Daller's consulting contract which became effective upon his retirement as President and CEO of Harleysville and \$401,843 annual payout under Supplemental Executive Retirement Benefit Plan, pursuant to Mr. Daller's previous employment.
- (5) Mr. Wimmer received payouts under 2 separate deferred compensation plans assumed by Harleysville pursuant to the merger and acquisition of Citizens Bank and Trust Company of Palmerton. During 2006, he received \$26,106 payout under the Citizens Bank and Trust Company of Palmerton 1983 Deferred Compensation Plan and \$36,566 payout under the Citizens Bank and Trust Company of Palmerton 1987 Deferred Compensation Plan.
- (6) Mr. Yocum retired from the Board of Directors of Harleysville and Harleysville National Bank on January 8, 2006 and was immediately appointed Director Emeritus. Mr. Yocum received payouts under 2 separate Harleysville deferred compensation plans. During 2006, he received \$30,918 payout under the Deferred Compensation Plan for the Directors of Harleysville National Bank & Trust effective July 1, 1985 and \$18,165 payout under the Deferred Compensation Plan for the Directors of Harleysville National Bank & Trust 1989 Plan.
- (7) Includes fees paid in connection with service on the corporation's western regional advisory board.
- (8) Includes fees paid in connection with service on the corporation's northern regional advisory board.

The Compensation Committee approved and authorized the award of 1,575 stock options to Mr. Yocum in 2006 that would vest immediately and be exercisable for the full term of the option, during his lifetime, subsequent to his appointment to emeritus status as of the date of retirement.

1998 Independent Directors Stock Option Plan, as amended

The corporation maintains a stock option plan to advance the development, growth and financial condition of the corporation and its subsidiaries; and, to secure, retain and motivate non-employee directors. The Plan provides that retiring directors who are appointed to emeritus status may, during their lifetime, have the full term of each respective option to exercise any options that are outstanding as of the date of their retirement.

During 2006, there were 6,000 shares granted under the plan. There were 25,132 options exercised under the plan during 2006. As of December 31, 2006, a total of 47,098 shares remained available for grant under the plan, reflecting adjustment for a 5 percent stock dividend paid on September 15, 2006.

Deferred Compensation Plans for the Directors of Harleysville National Corporation

The corporation maintains deferred compensation plans for its directors; the 1985 Plan and the 1989 Plan. In the past, certain directors elected to defer, with interest, all or part of their compensation for future distribution. Under the terms of the plan, benefits can be paid out to the respective directors over a 10-year period. Should the director die before age 70 or before receiving all of the benefits, the remaining benefit would be paid to his or her beneficiary until age 70 or for ten years, whichever is greater. This plan is an unfunded plan, which is subject to substantial risk of forfeiture, and the director is not deemed vested in the plan, according to the terms of the plan. Currently, Messrs. Bateman, Daller and Yocum participate in the plans.

Additionally, Mr. Wimmer, as a former director of the former Citizens Bank and Trust Company of Palmerton, PA, acquired by Harleysville on April 28, 2000, continues to accrue benefits and receive payouts under 2 separate deferred compensation plans in effect at that time, and as agreed under terms of the Agreement and Plan of Reorganization.

Walter E. Daller, Jr. - Supplemental Executive Retirement Plan

Harleysville Management Services maintains a Supplemental Executive Retirement Plan for Walter E. Daller, Jr., Chairman of the Board of Directors of the corporation and the bank. The plan provides for payment to the covered employee of an annual supplemental retirement benefit equal to 70% of his final five year average compensation, reduced by the employer's share of social security, defined benefit pension and available employer's 401(k) matching contribution. There is a lifetime payout in retirement benefits with a minimum payout of 10 years.

Walter E. Daller, Jr. - Consulting Agreement

Mr. Daller's employment agreement ended at the time that he retired from active management as Chief Executive Officer of the corporation on March 31, 2005. Mr. Daller, Chairman of the Board of Directors of the corporation and the bank, entered into a Consulting Agreement and General Release with the corporation and the bank effective April 1, 2005. Pursuant to the Consulting Agreement and under the terms of the Daller Employment Agreement, the corporation paid Mr. Daller a lump sum equal to 1.5 times his "Agreed Compensation," as defined in the Daller Employment Agreement, on the date of his retirement.

Among the terms of the Consulting Agreement: (1) Mr. Daller agreed to a general release to the corporation and the bank from any potential claims he could assert pursuant to his employment or his employment

agreement, dated October 26, 1998, entered into by and among Mr. Daller, the corporation and the bank; (2) Mr. Daller will continue to serve as Chairman of the Board of Directors of the corporation and the bank; (3) from April 1, 2005, through March 31, 2008, Mr. Daller will provide consulting advice to the corporation and bank; (4) the term of the agreement will automatically extend for one additional year at the end of the initial three years and on every anniversary of the Consulting Agreement, unless notice to terminate is given 180 days prior to renewal; (5) Mr. Daller will receive \$107,000 per year; (6) Mr. Daller will receive continuation of all life, disability, medical insurance and other normal health and welfare benefits for a period of 5 years after the date of retirement; and (7) Mr. Daller will receive dues and other expenses for membership at a country club. Upon retirement, he received an automobile, and continues to receive office space and reimbursement of certain business expenses. The Consulting Agreement contains a restrictive covenant precluding Mr. Daller from engaging in competitive activities in a certain area and a provision preventing Mr. Daller from disclosing proprietary information about the corporation.

EXECUTIVE OFFICERS

The following table provides information, as of March 7, 2007, about the corporation's executive officers.

| <u>Name</u> | <u>Age</u> | <u>Years in Position</u> | <u>Principal Occupation for the Past Five Years and Position Held with Harleysville and Subsidiaries</u> |
|-----------------------|------------|--------------------------|--|
| Jo Ann M. Bynon | 55 | 2005 – present | Senior Vice President, Harleysville and Harleysville National Bank |
| | | 2001 – 2004 | Vice President, Harleysville and Harleysville National Bank |
| | | 1995 – present | Corporate Secretary, Harleysville and Harleysville National Bank |
| Lewis C. Cyr | 37 | 2006 – present | Executive Vice President and Chief Lending Officer, Harleysville and Harleysville National Bank |
| | | 2004 – 2006 | Senior Vice President, Commercial Banking Director, Wachovia Bank |
| | | 2003 – 2004 | Senior Vice President, Corporate Finance Group Manager, Wachovia Bank |
| | | 1999 – 2003 | Director, Healthcare Finance Group, Wachovia Securities |
| John W. Eisele | 66 | 2004 – present | Executive Vice President, Harleysville and Harleysville National Bank; President, Millennium Wealth Management & Private Banking, a division of Harleysville National Bank |
| | | 2002 – 2004 | Executive Vice President, National Franchise - Bank of America/Fleet |
| | | 1999 – 2002 | Senior Vice President, National Division - Gruntal & Co., LLC |
| Michael B. High | 58 | 2005 – present | Executive Vice President and Chief Operating Officer, Harleysville and Harleysville National Bank |
| | | 2004 – 2005 | Executive Vice President, Treasurer and Chief Financial Officer, Harleysville and Harleysville National Bank |
| | | 1998 – 2004 | Chief Operating Officer & Chief Financial Officer, Progress Financial Corporation |
| James F. McGowan, Jr. | 60 | 2004 – present | Executive Vice President and Chief Credit Officer, Harleysville and Harleysville National Bank |
| | | 2003 – 2004 | Senior Vice President and Senior Credit Officer, Sovereign Bank |
| | | 1999 – 2003 | Senior Vice President and Senior Credit Officer, Summit Bank/Fleet |
| George S. Rapp | 54 | 2006 – present | Executive Vice President and Chief Financial Officer, Harleysville and Harleysville National Bank |
| | | 2005 – 2006 | Senior Vice President, Chief Financial Officer and Treasurer, Harleysville and Harleysville National Bank |
| | | 2004 – 2005 | Executive Vice President, Chief Financial Officer, Astea International |
| | | 2002 – 2004 | Senior Vice President, Chief Financial Officer, Advanta Bank Corp |
| Demetra M. Takes | 56 | 9/26/06 – present | Interim President and Chief Executive Officer, Harleysville |
| | | 2005 – present | Executive Vice President and Director, Harleysville and Harleysville National Bank |
| | | 2000 – present | President and Chief Executive Officer, Harleysville National Bank |

1993 Stock Incentive Plan

The corporation maintains the 1993 Stock Incentive Plan. The plan's purpose is to advance the development, growth and financial condition of the corporation. The plan provides that shares of our common stock be issued to certain employees of the corporation and banking subsidiaries.

A disinterested committee of the corporation's Board of Directors administers the plan. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock as the disinterested committee deems appropriate. No stock options remain available for grant under the 1993 Stock Incentive Plan. During 2006, 42,596 options were exercised under this plan. There are 21,081 options outstanding under the plan. All shares have been adjusted to reflect a 5 percent stock dividend paid on September 15, 2006.

1998 Stock Incentive Plan

The corporation maintains the 1998 Stock Incentive Plan. The plan's purpose is to advance the development, growth and financial condition of the corporation. The plan provides that shares of our common stock be issued to certain employees of the corporation and banking subsidiaries.

A disinterested committee of the corporation's Board of Directors administers the plan. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock as the disinterested committee deems appropriate. During 2006, no stock options were granted, a total of 325,969 stock options were exercised and 80,770 stock options were cancelled under this plan. 80,774 shares remain available for grant. All shares have been adjusted to reflect a 5 percent stock dividend paid on September 15, 2006.

2004 Omnibus Stock Incentive Plan, as amended

The corporation maintains the 2004 Omnibus Stock Incentive Plan. The plan's purpose is to advance the development, growth and financial condition of the corporation. The plan provides that shares of our common stock be issued to certain employees and/or directors of the corporation and banking subsidiaries.

A disinterested committee of the corporation's Board of Directors administers the plan. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock as the disinterested committee deems appropriate.

During 2006, the plan was amended and restated to (i) permit the board of directors to determine the "fair market value" of stock or any options or rights with respect thereto, or other awards under the Plan, by the closing market price as of the date of grant or other determination; and, (ii) provide that, from the effective date of the plan, the aggregate number of shares of stock that may be awarded to any employee during any calendar year shall not exceed 50,000 shares (whether the awards are settled in shares of stock, cash, or any combination of stock and cash). In this regard, form 8-K was filed with the Securities and Exchange Commission on November 15, 2006.

During 2006, 12,900 options were granted and 3,952 were cancelled under the 2004 Omnibus Stock Incentive Plan. The cancelled options were returned to the plan and are available for future grants. A total of 1,144,725 stock options remain available for grant under this plan. Shares have been adjusted to reflect a 5 percent stock dividend paid on September 15, 2006.

Millennium Bank Stock Compensation Program Converted to Harleysville Stock Options

In connection with the acquisition of Millennium Bank in 2004, Harleysville assumed all obligations under the Millennium Bank Stock Compensation Program. The change in control accelerated the vesting of all outstanding stock options to 100%. Upon consummation of the merger, outstanding stock options were converted according to proration parameters outlined in the merger agreement. 328,327 stock options were assumed on the effective date of the merger. Since the effective date, 285,329 stock options have been exercised and 36,209 were cancelled. A total of 6,789 stock options remain outstanding and exercisable under the program. No further stock options may be granted under the program. The options have been adjusted to reflect a 5 percent stock dividend paid on September 15, 2006.

Harleysville National Corporation Stock Bonus Plan

The corporation maintains the Harleysville National Corporation Stock Bonus Plan to recognize employees who have:

- a strong interest in the successful operation of the business;
- loyalty to the corporation and banking subsidiaries; and
- visible evidence of increased efficiency.

The Stock Bonus Plan is administered by the Compensation Committee of the corporation. The committee annually determines, in its sole discretion, the amount of shares the corporation awards.

The corporation awarded 227 shares on April 1, 2006, to certain employees for exemplary service throughout 2005. As of December 31, 2006, a total of 23,043 shares remain available for awards under the plan. The shares authorized and awarded under this plan have been adjusted to reflect a 5 percent stock dividend paid on September 15, 2006.

Compensation Discussion And Analysis

Overview of the Executive Compensation Program

The corporation's executive compensation program includes a number of fixed and variable compensation and benefit components, typical of programs among comparable community banking and financial services companies in our local and regional marketplace. The program provides participating executives with an industry-competitive level of total compensation when their collective and individual performances meet or exceed the goals approved by the Board of Directors.

Compensation Philosophy and Program Objectives

We believe that the compensation program for executives should directly support the achievement of specific annual, longer-term and strategic goals of the business, and, thereby, align the interests of executives with the interests of the corporation's shareholders. The current program provides sufficient levels of fixed income, in the forms of base salary and health & welfare benefits, to attract high caliber executive talent to the organization. It also provides competitive annual and longer-term incentive opportunities to encourage specific performance and to reward the successful efforts of executives. The incentive opportunities are structured to produce a performance-leveraged program format where executives are expected to derive as much as 40% to 60% of their total compensation, depending on their role in the organization, from short- and longer-term incentive opportunities, *but only when performance targets are met on a consistent basis*. Lastly, the current program also contains certain benefit features, provided on a selective basis; to ensure equitable benefits coverage for our highly compensated employees and transition support in the event of substantial organization or ownership change. These provisions support retention of good performers by the organization.

We believe that the features and composition of the current program are consistent with practices of other comparable community banking and financial services organizations in our marketplace and that it balances the need for competitive pay opportunities at the executive level with shareholders' expectations for reasonable return on their investment.

Program Management

The Compensation Committee of the Board of Directors has primary responsibility for the design and administration of the executive compensation program. It reviews the make-up and administration of the executive compensation program throughout the year in light of changing organization needs and operating conditions and changing trends in industry practice. In evaluating program effectiveness, the Compensation Committee utilizes information from management and the services of an outside consultant. Strategic Compensation Planning, Inc. of Malvern, PA is the Compensation Committee's outside consultant on executive and director compensation matters.

The Committee currently consists of three (3) directors, all of whom qualify as independent members of the Board. Harold A. Herr serves as Chair of the Committee. Stephanie S. Mitchell and A. Ross Myers also serve on the Committee.

Role of Executive Management in the Pay Decision Process

The Compensation Committee is responsible for recommending compensation-related decisions to the Board of Directors for final approval. In formulating its recommendations, the Compensation Committee will regularly seek information about the performance of the business, organization staffing requirements and the performance levels of incumbent executives from the Chief Executive Officer. It will also utilize the services of the corporation's Chief Financial Officer and, as circumstances suggest, other officers of the corporation. The Compensation Committee weighs the information provided by officers carefully, especially the recommendations of the Chief Executive Officer on decisions affecting subordinate executives, but ultimately makes its decisions and formulates recommendations for Board approval independently. The performance of the chief executive officer is reviewed and appraised by the Compensation Committee of the Board of Directors. The Compensation Committee makes any recommendation of pay adjustments and other elements of compensation for the chief executive officer to the Board of Directors for its consideration.

Program Review and Pay Decision Process

Starting in the early Fall of a calendar year and usually continuing through January of the following year, the Compensation Committee (1) receives information on current executive compensation levels in the industry and industry program practices, (2) conducts a comprehensive review of the corporation's program structure and provisions, and (3) considers salary and benefit adjustments and incentive awards for executives. After examining industry practice information provided by its outside consultant, the Compensation Committee determines (1) if the content and structure of the corporation program is still competitive, (2) if the current provisions remain consistent with the corporation's overall pay philosophy, and (3) if they continue to support achievement of business objectives. After deciding on the program structure for the coming calendar year, the Compensation Committee will examine the current compensation and benefit levels of incumbent executives in light of their continuing or changing roles in the business, the assessments of their individual performances, and industry practice trends.

Based on the information gathered about each executive, the Compensation Committee will formulate recommendations on possible salary adjustments for executives during the coming calendar year. It will also determine annual incentive awards for executives based on results achieved against goals and objectives defined at the beginning of the year, and it will determine appropriate longer-term incentive awards, usually in the form of stock options or restricted stock grants. These recommendations will be presented to the full Board of Directors for consideration, usually in January of the new fiscal (calendar) year. As incentive awards for the year ending are calculated, the Compensation Committee works with the Chief Executive Officer to construct executive performance plans for the next calendar year (the new fiscal year). The Compensation Committee will formulate their recommendations on performance goals and award opportunities for Board consideration and approval.

The Compensation Committee is called upon to consider pay related decisions throughout the calendar year as executives are reassigned (promoted) and new executives join the organization. In these instances, the Compensation Committee will review all aspects of the executive's compensation including base salary level, annual incentive opportunities, longer-term incentive awards, participation in special benefit plans, and employment contract provisions, if applicable.

Pay Decision Factors and Considerations

The following factors typically influence Compensation Committee recommendations on pay and benefits for corporation executives:

- *Salary:* executive's overall performance during the year ending, changes in organization role and scope of responsibility, current salary in relation to the position's market value, and any significant changes in the industry's pay practices for comparable positions.

- *Annual Incentive Awards*: competitive industry practice with respect to size of awards, and actual performance (achievement) against goals and objectives assigned at the beginning of the fiscal year.
- *Longer-term Incentive Awards*: competitive industry practice with respect to size of awards and the typical "mix" of stock options, restricted shares and other forms of equity-based grants, recent performance of the corporation and the individual executive, applicable accounting rules for expensing equity awards, and shareholder concerns about dilution and overhang.
- *Nonqualified Benefits*: tax rules on qualified benefit plans, likely replacement income benefits for executives compared to other categories of employees within the organization, competitive industry practice for comparable type and level of executive positions.
- *Perquisites*: the needs of the executive's position, i.e., frequency of need to travel to other corporate locations, or meet with corporate clients and prospective clients, and competitive industry practices for comparable executive roles.
- *Employment Contracts*: where they serve corporate needs for confidentiality about business practices and plans and preservation of the customer base (non-competition and non-solicitation provisions) and competitive industry practices.

Comparator Base: The Basis for Defining Competitive Compensation Levels and Practices

The types and levels of compensation included in the corporation executive compensation program are consistent with current features and programming trends among similar size and type organizations in the corporation's local and regional marketplace.

Annually, the Compensation Committee asks Strategic Compensation Planning, Inc., its outside consultant, to review survey reports on national and regional compensation practice within the corporation's industry group, focusing on pay levels and practices among community banking and diversified financial services institutions based in the Mid-Atlantic Region and having between \$2.5B and \$5.0B of assets. This range of institutions represents banking companies that are somewhat smaller and somewhat larger than the corporation. The asset range will be modified from time to time as the corporation's operating circumstances change. The consultant also examines proxy information on specific institutions in the corporation's marketplace that fall into the comparison standards noted. For the 2007 program planning review, the outside consultant reviewed executive compensation information from the following institutions in Delaware, New Jersey, New York, Ohio and Pennsylvania:

| | | |
|--------------------------------|---------------------------|-----------------------------|
| Community Banking System, Inc. | NBT Bancorp. | Sun Bancorp. |
| Dime Community Bancshares | Park National Corporation | Trustco Bank Corp. |
| First Financial Bancorp. | Partners Trust Financial | U.S.B. Holding Co., Inc. |
| F.N.B. Corporation | Signature Bank | Wesbanco, Inc. |
| KNBT Bancorp. | Sterling Financial | WSFS Financial Corp. |
| National Penn Bancshares | S&T Bancorp. | Yardville National Bancorp. |

Program Components

There are six (6) elements in the current executive compensation program:

1. **Base Salary.** Base salary opportunities are set at the median level of industry practice for comparable jobs in like size and type community banking and financial service organizations. Within the defined competitive range, an executive's salary level is based initially on his/her qualifications for the assignment and experience in similar level and type roles. Ongoing, salary adjustments reflect the individual's overall performance of the job against organization expectations and may also reflect changes in industry practices. For most of the corporation's executive positions, salary will provide 50%-70% of *total annual compensation*, when considering the value of short-term incentive awards and benefits provided by the organization.

2. **Health & Welfare Benefits.** Executives participate in the corporation's qualified health & welfare benefits program on the same terms and conditions as all other employees of the corporation. Executives participate in the corporation's 401(k) plan and pension plan on the same terms and conditions as other employees.
3. **Annual Performance Incentives.** The annual performance incentive award plan provides participating executives with opportunities to earn additional cash compensation in a given year when corporate and business unit operating results and individual performance contributions meet or exceed established thresholds of acceptable achievement. Currently, these awards can provide 20% to as much as 35% of an executive's total annual compensation when target levels of performance are achieved. Annual work goals, performance standards and other related conditions for earning incentive awards are approved by the Board of Directors.
4. **Longer-term Performance Incentives.** Executives are eligible to participate in longer-term incentive award plans established to focus executive efforts on the strategic directions and goals of the business and to reward them for their successes in these areas. Awards can result in additional cash compensation or equity grants in the form of stock options or restricted stock. *While the size of such awards may increase or decrease based on current business performance, it is the intention of the Compensation Committee to recommend such awards at least annually as an incentive to focus executives' future efforts on longer-term needs and objectives of the business.*

Equity Grant Plans

Currently, the corporation has a 1993 Stock Incentive Plan, 1998 Stock Incentive Plan, a 2004 Omnibus Stock Incentive Plan and a Stock Bonus Plan. For more information on our Equity Incentive Plans, see Equity Compensation Plan Information.

The Compensation Committee recommended to the Board and the Board authorized the awarding of stock options to executives and certain employees. The timing of grants was not tied to the release of negative or positive material information about the corporation. Prior to 2003, options were awarded from time to time, as recommended by the Committee and approved by the Board and were generally made during the fourth calendar quarter. Past recommendations were not made on a set or regular schedule, and the Corporation does not have a policy of making awards on a set or regular schedule or at specific times a year. The corporation has not established a policy regarding executive ownership of corporation stock and/or retention guidelines applicable to equity awards to executives.

5. **Nonqualified Benefits and Perquisites.** Named Executive Officers participate in a nonqualified retirement income benefit plan that supplements benefits from the Corporation's qualified pension and 401(k) plans for all employees. The supplemental plan, or SERP, is made necessary because of Federal restrictions on retirement plan benefits to highly compensated employees. The supplemental plan is designed to make up benefits lost under the qualified plans because of the Federal restrictions. Actual benefit opportunities vary among the participating executives, but generally the benefit level provided under the SERP is offset by payments from Social Security, the pension plan and the 401(k) plan. A typical benefit level is up to 50% of average total annual cash compensation over the five (5) years preceding retirement. In some instances, the SERP benefit is vested over service time, but for most executives today, the benefit is contingent on active employment with the Corporation at the time of retirement.
 - a. Named Executive Officers are provided with a car allowance and Ms. Takes is provided a company vehicle. Provision of a company vehicle and for car allowance is standard in the financial services industry as the Named Executive Officers frequently meet clients and business associates offsite.
6. **Employment Contracts and Change of Control Agreements.** In line with current industry norms, our top executives are employed by the company under formal contracts which define their roles in the business and the terms and conditions under which they are compensated during and, under some circumstances, i.e. a change of control, after employment with the corporation.

- a. *Severance in the Event of Termination Not for Cause.* Employment contracts with Named Executive Officers provide for severance benefits equal to one (1) times total annual cash compensation plus continuation of basic health & welfare benefits for a period of twelve months. In the event of a termination related to a Change of Control, severance benefits are increased to two (2) times total annual cash compensation and, in some cases, 2.99 times total annual cash compensation plus continuation of health & welfare benefits for a corresponding period of months.
- b. *Tax Gross-up Provision.* None of the Named Executive Officers have a tax gross-up provision in their respective employment contracts. In the event that severance payments exceed the deduction limits under IRS Code Section 4999, the company may reduce the payments to the executive by an amount necessary to avoid the excise tax.

Recent Actions: 2006 and Q1, 2007

During 2006 and the first quarter of 2007, the corporation, through its Compensation Committee and Board of Directors, has made a number of important decisions regarding executive compensation. The most important actions are summarized here.

Base Salaries. At the beginning of 2006, the then CEO and the EVP/COO of the corporation received significant salary increases in the range of 15%-20% to bring their respective base salary levels within the competitive salary range for their respective positions. Other executives received modest base salary increases reflecting typical "market movement" for their positions.

Annual Incentives. For 2006, the Board had established a series of corporate, business unit and individual goals for each Named Executive Officer. All goals were weighted to reflect their relative importance, with corporate goals weighted at 50% or more of an executive's total annual incentive award opportunity. Executives achieved Target level performance on earnings per share growth but fell below Threshold (minimum acceptable performance level for incentive awards) on Net Interest Margin performance. Executives also qualified for partial payouts against business unit and individual performance goals. The 2007 executive incentive plan will focus on net income growth with limited opportunity for a discretionary award based on overall contribution to the business.

Longer-term Incentives. As noted earlier in this section, there were no stock grants made to executives at the beginning of 2006. During 2006, the Compensation Committee, on the advice of its outside consultant, changed its equity grant philosophy to make annual equity grants, in its discretion where appropriate, as an incentive to drive future performance rather than as a reward for past performance. The Compensation Committee believes this change in policy is consistent with the current practice trend among comparable banking and financial services institutions.

Employment Contracts and Change of Control Agreements. There are no substantial changes in the corporation's practice to use such formal arrangements with key executive level personnel. The Compensation Committee is establishing a more rigorous and consistent practice of reviewing existing arrangements as they come due for renewal.

Status of the Program and Likely Practices Going Forward

The structure of the corporation program was established several years ago and it has been continuously refined to meet the changing needs of the business and to maintain a competitive posture in the marketplace for executive talent. Currently, all of the corporation's Named Executive Officers are paid salaries that fall in the competitive median (50th percentile) range of industry practice, but none are paid above the actual median market value for their respective positions. In the case of the Interim CEO, that executive is paid an actual salary that is commensurate with her position as President of the Harleysville National Bank. In addition, the Interim CEO also receives a monthly stipend of \$7,500 for the duration of that interim status. The combination of current salary and the stipend places total base compensation in the low range for the CEO position among comparable institutions.

Recent annual incentive awards have been modest, reflecting the corporation's results against the goals established for 2006 and 2005. The Board is again offering executives industry competitive incentive award opportunities in 2007 but the achievements required to earn those awards are stringent, reflecting the corporation's

commitment to being a "best in class" performer. Equity grants to executives over the past two years have been modest when compared to practices of other institutions. The Compensation Committee has recommended to the Board a change in the corporation's equity grant practice, moving to annual grants as an incentive to encourage future performance rather than as a reward for past performance. Actual grants may still vary based on most recent corporate performance, but it is likely that equity grants will be made annually to corporate executives. *Some of these future grants may include performance vesting in lieu of the traditional time vesting requirements attached to past grants.*

The Compensation Committee is currently considering introduction of an intermediate-term incentive plan for executives using restricted stock grants with performance vesting over a 3-year period, 2007-2009. If such a plan is adopted, it would likely preclude any additional stock option grants during this time period.

Nonqualified Benefits. The corporation will continue to offer supplemental retirement income benefit plans to selected executives, both as a make-up for benefits lost to Federal restrictions and as a retention device, using vesting requirements as a condition for receipt of such benefits.

Perquisites. The corporation's program has always been modest, offering use of a company vehicle primarily to those executives who travel among the corporation's multiple branch and operations center locations and those who frequently meet with clients and prospects offsite. Similarly, club memberships are only provided for those executives who can utilize them in conducting the Corporation's business. The Interim CEO is provided a car, while other named executive officers receive a car allowance.

Employment Contracts. Current contracts vary from one to three years in duration. All contracts have a renewal feature that provides the corporation with the opportunity to assess the executive's recent performance and potential prior to extending the contract. The Compensation Committee has responsibility for this review and will specifically authorize contract extensions.

The Compensation Committee believes that the executive compensation program structure is competitive, generally mirroring the make-up of programs in similar institutions. Further, it intends to maintain the current leveraged approach to total compensation, directly tying a significant portion of an executive's total earnings to achievements against goals and objectives approved by the Board of Directors.

Compensation Committee Report

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management, and based on such review and discussions, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the Proxy Statement.

Compensation Committee

Harold A. Herr, Chairman

Stephanie S. Mitchell

A. Ross Myers

Compensation Committee Interlocks and Insider Participation

During 2006, no current or former officer or employee of the corporation or of any of its banking subsidiaries served on the compensation committee. In addition, none of the members of the committee had any relationship with the corporation or any of its subsidiaries that would require disclosure under Item 404 of the Securities and Exchange Commission's Regulation S-K relating to insider transactions and indebtedness of management.

Executive Compensation

The following table shows compensation to the current Chief Executive Officer, the prior Chief Executive Officer, the Chief Financial Officer, the other three most highly compensated executive officers who were serving as executive officers at the end of 2006 and whose total annual compensation exceeded \$100,000 in 2006, and one additional individual (Mikkalya W. Murray) who would have been among the three highest paid other executive officers had she been serving as an executive officer at December 31, 2006. These were our "named executive officers" for 2006.

Summary Compensation Table

| Name & Principal Position | YEAR | Salary \$ | Bonus (1) \$ | Option/ SAR Awards \$ | Change in Pension Value and Non- qualified Deferred Compensation Earnings \$ | All Other Compensation (9) \$ | Total Compensation \$ |
|--|------|--------------|-----------------|--------------------------------|---|--|-----------------------------|
| Demetra M. Takes Interim President & CEO, & President & CEO Harleysville National Bank | 2006 | \$295,200 | \$80,728 | \$33,404 (2) | \$124,986 | \$8,485 | \$542,803 |
| Gregg J. Wagner Former President & CEO – separated 9/26/2006 | 2006 | \$278,831 | -0- | \$41,618 (3) | \$15,388 | \$693,203 | \$1,029,040 |
| George S. Rapp Executive Vice President & CFO | 2006 | \$171,192 | \$40,444 | \$7,719 (4) | \$17,289 | \$9,017 | \$245,661 |
| Michael B. High Executive Vice President & COO | 2006 | \$282,000 | \$71,381 | \$39,132 (5) | \$112,495 | \$14,608 | \$519,616 |
| John W. Eisele Executive Vice President President, Millennium Wealth Management & Private Banking | 2006 | \$241,771 | \$73,528 | -0- | \$42,117 | \$11,722 | \$369,138 |
| James F. McGowan, Executive Vice President & CCO | 2006 | \$153,079 | \$16,073 | \$18,051 (6) | \$22,763 | \$10,782 | \$220,748 |
| Mikkalya W. Murray Former Executive Vice President and Managing Director of Millennium Wealth Management & Private Banking (8) | 2006 | \$117,578 | -0- | \$29,804 (7) | \$18,378 | \$220,976 | \$386,736 |

(1) Cash bonus earned in 2006; paid in first quarter 2007.

(2) Represents the value of equity compensation awarded to Ms. Takes prior to 2006, with service periods extending into 2006, and recognized for financial reporting purposes during 2006: 6,945 options granted 12/30/2003, 5-year vesting, FAS 123(R) value = \$7.4941; 8,269 options granted 12/30/2004, 5-year vesting, FAS 123(R) value = \$6.7192; and, 10,762 options granted 12/8/2005, 5-year vesting, FAS 123(R) value = \$5.6104. Refer to 2006 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.

(3) Represents the value of equity compensation awarded to Mr. Wagner prior to 2006, with service periods extending into 2006, and recognized for financial reporting purposes for 2006: 8,682 options granted 12/30/2003, 5-year vesting, FAS 123(R) value = \$7.4941; 8,269 options granted 12/30/2004, 5-year vesting, FAS 123(R) value = \$6.7192; and, 15,749 options granted 12/8/2005, 5-year vesting, FAS 123(R) value = \$5.6104. However, Mr. Wagner forfeited all awards that remained outstanding on the date of his separation, September 26, 2006. Refer to 2006 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.

(4) Represents the value of equity compensation awarded to Mr. Rapp prior to 2006, with service periods extending into 2006, and recognized for financial reporting purposes during 2006: 2,205 options granted 5/18/2005, 5-year vesting, FAS 123(R) value = \$5.2451; and, 3,675 options granted 12/8/2005, 5-year vesting, FAS 123(R) value = \$5.6104. Refer to 2006 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.

- (5) Represents the value of equity compensation awarded to Mr. High prior to 2006, with service periods extending into 2006, and recognized for financial reporting purposes during 2006: 11,576 options granted 2/23/2004, 5-year vesting, FAS 123(R) value = \$6.6316; 8,269 options granted 12/30/2004, 5-year vesting, FAS 123(R) value = \$6.7192; and, 11,550 options granted 12/8/2005, 5-year vesting, FAS 123(R) value = \$5.6104. Refer to 2006 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.
- (6) Represents the value of equity compensation awarded to Mr. McGowan prior to 2006, with service periods extending into 2006, and recognized for financial reporting purposes during 2006: 5,789 options granted 8/23/2004, 5-year vesting, FAS 123(R) value = \$5.9225; 2,756 options granted 12/30/2004, 5-year vesting, FAS 123(R) value = \$6.7192; and, 5,618 options granted 12/8/2005, 5-year vesting, FAS 123(R) value = \$5.6104. Refer to 2006 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.
- (7) Represents the value of equity compensation awarded to Ms. Murray prior to 2006, with service periods extending into 2006, and recognized for financial reporting purposes during 2006: 5,237 options granted 12/30/2003, 5-year vesting, FAS 123(R) value = \$7.4941; and, 5,617 options granted 12/8/2005, 5-year vesting, FAS 123(R) value = \$5.6104. However, Ms. Murray forfeited all awards that remained outstanding on the date of her resignation, September 1, 2006. Refer to 2006 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.
- (8) See footnote (16) to the Beneficial Ownership table on page 7.
- (9) All Other Compensation

| Name | Year | Car Allowance (a) (\$) | Country Club Membership (\$) | Harleysville's 401(k) Plan Contribution (\$) | Exec-u-care Health Benefit Plan (\$) | Contract Payouts (b) (\$) |
|------------|------|---------------------------|---------------------------------|---|---|------------------------------|
| D. Takes | 2006 | n/a | -- | \$6,600 | \$1,885 | -- |
| G. Wagner | 2006 | \$47,932 (c) | -- | \$6,600 | -- | \$638,671 (d) |
| G. Rapp | 2006 | \$3,881 | -- | \$5,136 | -- | -- |
| M. High | 2006 | \$3,469 | \$4,539 | \$6,600 | -- | -- |
| J. Eisele | 2006 | \$5,122 | -- | \$6,600 | -- | -- |
| J. McGowan | 2006 | \$6,190 | -- | \$4,592 | -- | -- |
| M. Murray | 2006 | \$3,130 | -- | \$3,527 | \$704 | \$213,615 (e) |

- (a) Taxable benefit pursuant to annual car allowance, computed by subtracting the individual's business expense from the total annual allowance.
- (b) Payments on termination of employment either pursuant to the terms of employment agreements or pursuant to severance agreements.
- (c) Includes taxable benefit of car allowance, \$6,112, and the value of Mr. Wagner's company car, \$41,820, to which he received title upon termination. Refer to Mr. Wagner's separation agreement below.
- (d) Includes \$623,671 contract payout; and \$15,000 paid directly to Outplacement Services on Mr. Wagner's behalf.
- (e) Contract payout includes \$183,815 salary; \$26,000 negotiated settlement in connection with the accumulated retirement benefit; \$2,000 cash value of medical care for 1-year; and \$1,800 vision and dental insurance for 1-year.

Gregg J. Wagner, Separation Agreement

Effective December 8, 2006, Harleysville National Corporation, Harleysville National Bank and Trust Company and Harleysville Management Services, LLC entered into a Complete Settlement Agreement and General Release (the "Agreement") with Gregg J. Wagner dated November 29, 2006. The Agreement relates to the termination of Mr. Wagner's employment and modifies the terms of his employment agreement that was dated January 1, 2005 and was effective April 1, 2005. Mr. Wagner served as President and Chief Executive Officer of the corporation until September 26, 2006.

The material terms of the Agreement are summarized as follows:

- Mr. Wagner received as his severance package amounts equal to \$623,671 minus all appropriate withholdings and/or deductions. Mr. Wagner also received title to his company car with a value of \$41,820. The corporation also paid \$15,000 for outplacement services directly to the outplacement agency.
- Mr. Wagner agreed to release the corporation and its affiliates and all other releasees as identified in the Agreement from all claims and rights including but not limited to those arising from or based upon his employment or the termination of his employment and any related statute or law.
- The corporation agrees to indemnify Mr. Wagner from any legal process in any actions or suits arising out of his service as a director, officer or employee of the corporation subject to certain limitations.
- Mr. Wagner agrees not to disclose any confidential information of the corporation and return any confidential documents and information to the corporation.

- Mr. Wagner agrees to not compete with the corporation in Berks, Bucks, Chester or Montgomery Counties, Pennsylvania for a six-month period following the termination of his employment. Mr. Wagner also agrees to not contact, solicit or induce any customer, referral source or employee of the corporation to become a customer, referral source or employee of anyone other than the corporation for a period of one year.

Mikkalya W. Murray, Separation Agreement

The employment of Mikkalya W. Murray with the corporation terminated effective September 1, 2006. In connection with the termination, Harleysville agreed to make the following payment conditioned by legal release from all claims and rights including but not limited to those arising from or based upon her employment or the termination of her employment and any related statute or law.

- Payment of all days worked and all business expenses incurred, including pay for time up to the date of the agreement
- 1 times annual salary, totaling \$183,815
- 12 months benefit continuation, or the value of benefits that cannot be continued in the group plan, totaling \$29,800
- Modified non-compete agreement, 2-years in duration, permitting Ms. Murray to work in the following counties: Philadelphia, Delaware, Chester, and Lancaster counties, and counties outside the state of Pennsylvania

Grants of Plan-Based Awards

No equity-based awards or other non-equity incentive plan awards were granted to any named executive officers during the fiscal year ended December 31, 2006 or during 2007 prior to the date of this Proxy Statement for performance by any named executive officer in 2006.

Option Exercises and Stock Vested

The following table shows information about exercises of stock options by the named executive officers during 2006. No restricted stock, stock appreciation rights or other equity-based awards have been granted to any named executive officers. The options and information shown in the table have been adjusted to reflect a 5 percent stock dividend paid on September 15, 2006.

| Name | Option Exercises | Option Awards |
|--------------------|---|---------------------------------------|
| | Number of Shares Acquired on Exercise (#) | Value Realized on Exercise (\$) |
| Demetra M. Takes | 97,282 (1) | \$947,654 |
| Gregg J. Wagner | 46,525 (1) | \$522,407 |
| George S. Rapp | -0- | \$0 |
| Michael B. High | -0- | \$0 |
| John W. Eisele | -0- | \$0 |
| James F. McGowan | -0- | \$0 |
| Mikkalya W. Murray | -0- | \$0 |

(1) Options exercised were granted under the 1993 and 1998 Stock Incentive Plans.

The options exercised by named executive officers were all or portions of awards granted on October 27, 1998 and December 1, 2000. The exercised awards were incentive and/or nonqualified stock options. Ms. Takes sold all shares for financial planning purposes. Mr. Wagner sold 21,550 shares and retained 24,975 shares.

Outstanding Equity Awards

The following table shows information about outstanding equity awards held by named executive officers at December 31, 2006. No restricted stock, stock appreciation rights or other equity-based awards have been granted to any named executive officers during 2006. The options and pricing shown in the table have been adjusted to reflect a 5% stock dividend paid on September 15, 2006.

| Name | Outstanding Equity Awards At Fiscal Year-End | | | |
|--------------------|---|---|-------------------------------------|------------------------------|
| | Option Awards | | Option Exercise Price (\$) | Option Expiration Date |
| | Number of Securities Underlying Unexercised Options | Number of Securities Underlying Unexercised Options | | |
| | (#) Exercisable | (#) Unexercisable | | |
| Demetra M. Takes | 4,167 (1) | 2,778 | \$27.37 | 12/30/2013 |
| | 3,307 (2) | 4,962 | \$24.54 | 12/30/2014 |
| | 2,153 (3) | 8,609 | \$20.10 | 12/08/2015 |
| Gregg J. Wagner | -0- | -0- | -0- | -- |
| George S. Rapp | 441 (4) | 1,764 | \$19.54 | 05/18/2015 |
| | 735 (3) | 2,940 | \$20.10 | 12/08/2015 |
| Michael B. High | 4,630 (5) | 6,946 | \$24.22 | 02/23/2014 |
| | 3,307 (2) | 4,962 | \$24.54 | 12/30/2014 |
| | 2,310 (3) | 9,240 | \$20.10 | 12/08/2015 |
| John W. Eisele | -0- | -0- | -0- | -- |
| James F. McGowan | 2,315 (6) | 3,474 | \$21.63 | 08/23/2014 |
| | 1,102 (2) | 1,654 | \$24.54 | 12/30/2014 |
| | 1,123 (3) | 4,495 | \$20.10 | 12/08/2015 |
| Mikkalya W. Murray | -0- | -0- | -0- | -- |

- (1) Incentive stock option granted December 30, 2003, vesting in 5 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.
- (2) Incentive stock option granted December 30, 2004, vesting in 5 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.
- (3) Incentive stock option granted December 8, 2005, vesting in 5 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.
- (4) Incentive stock option granted May 18, 2005, vesting in 5 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.
- (5) Incentive stock option granted February 23, 2004, vesting in 5 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.
- (6) Incentive stock option granted August 23, 2004, vesting in 5 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.

Ms. Murray and Mr. Wagner forfeited all outstanding options on their respective termination dates, September 1, 2006 and September 26, 2006.

Pension Benefits

The following table shows information about retirement payments and benefits for named executive officers as of December 31, 2006.

| Name | Plan Name | Pension Benefits | | |
|--------------------|---------------------------------------|--|--|--|
| | | Number of Years Credited Service | Present Value of Accumulated Benefit | Payments During Last Fiscal Year |
| | | (#) | (\$) | (\$) |
| Demetra M. Takes | HNC Pension Plan | 25 | \$374,944 | -0- |
| | Supplemental Employee Retirement Plan | - | \$804,452 | -0- |
| Gregg J. Wagner | HNC Pension Plan | 13 | \$ 65,884 | -0- |
| | Supplemental Employee Retirement Plan | - | -0- | -0- |
| George S. Rapp | HNC Pension Plan | 2 | \$ 17,289 | -0- |
| | Supplemental Employee Retirement Plan | - | -0- | -0- |
| Michael B. High | HNC Pension Plan | 3 | \$ 43,514 | -0- |
| | Supplemental Employee Retirement Plan | - | \$162,762 | -0- |
| John W. Eisele | HNC Pension Plan | 2 | \$ 28,808 | -0- |
| | Supplemental Employee Retirement Plan | - | \$ 54,033 | -0- |
| James F. McGowan | HNC Pension Plan | 2 | \$ 21,666 | -0- |
| | Supplemental Employee Retirement Plan | - | \$ 25,679 | -0- |
| Mikkalya W. Murray | HNC Pension Plan | 13 | \$ 94,492 | -0- |
| | Supplemental Employee Retirement Plan | - | -0- | -0- |

Pension Plan. The corporation maintains a non-contributory funded pension plan for all employees of its subsidiaries over age 21, who have completed 1 year of service and who work a minimum of 1000 hours in the year. Annual benefits to eligible retired employees at age 65 or, if later, the 5th anniversary of the first day of the plan year in which they began to participate in the plan, are provided according to the following formula:

The product of (A) and (B), where

(A) is the sum of:

- (i) .65% of average compensation, plus
- (ii) .60%, (.56% or .52% for participants whose social security retirement age is 66 or 67, respectively) of average compensation above the covered compensation level of an individual attaining the social security retirement age in the current plan year; and

(B) is the participant's years of service as of his normal retirement date, but not in excess of 25 years.

Covered compensation is a 35-year average of the current and prior Social Security Taxable Wage Bases. Average compensation is the average of the highest 5 consecutive salaries, excluding bonuses, during the last 10 years of employment. Compensation for pension purposes is limited to \$220,000 (for calendar year 2005 the compensation limit was \$210,000; for calendar year 2004 the compensation limit was \$205,000; and for 2002 and 2003 the compensation limit was \$200,000) as required under federal pension law. Total contributions by Harleysville National Bank to the pension plan for the years ending December 31, 2006, 2005, and 2004, were \$1,250,000, \$1,500,000 and \$1,500,000, respectively.

Supplemental Executive Retirement Plan. Harleysville Management Services maintains a Supplemental Executive Retirement Plan for certain officers and key employees. The plan provides for payment to the covered employee of an annual supplemental retirement benefit of up to 50% of their average annual compensation upon retirement, offset by 50% of the employee's social security retirement income, defined pension benefit, and projected income from the employer's 401(k) matching contributions. There is a lifetime payout in retirement benefits with a minimum payout of 10 years. There is a pre-retirement death benefit, payable for 10 years, of 100% of the average annual compensation for the first year, and up to 50% of the average annual compensation for the next 9 years.

Non-Qualified Deferred Compensation

None of the named executive officers received any nonqualified deferred compensation during 2006.

401(k) Plan

The corporation maintains a 401(k) plan. It is a tax-exempt profit-sharing plan, qualified under section 401(a) of the Internal Revenue Code. All employees are eligible to participate on the first day of the calendar quarter following 3 months of service, if they are 21 years of age. They may contribute a maximum (up to IRS dollar limits) of their salary on a pre-tax basis, with a 50% employer-match, up to a maximum of 3% of salary. The plan assets, which include the corporation's stock and other investment options, are managed by an independent investment manager. Distributions are made upon normal retirement at age 65, early retirement at age 55 with a minimum of 15 years of service, or upon disability, death, termination or hardship. A participant may elect distributions in a lump sum or in installments.

Potential Payments Upon Termination Or Change In Control

Payments under each executive's contract as detailed below would be triggered by termination of executive's employment for cause (misconduct for example), good reason, disability, death, voluntary separation absent good reason (as in the case of retirement), involuntary termination absent cause (as in the case of poor performance), and also in the event of a change in control. Good reason is defined as (i) the assignment of duties and responsibilities inconsistent with executive's contracted position, (ii) a reduction in salary or benefits, or (iii) a reassignment that requires executive to move his/her principal office more than 50 miles from the corporation's principal office. The Compensation Committee of the Board shall confirm the reason for separation. All payments are contingent upon the execution of a legal release, and may be made by either lump sum or monthly installment, except for pension payments which shall be made according to the executive's election under the pension plan.

Post-termination, each executive is prohibited from competing directly or indirectly with the corporation for a period of 1 year within a non-competition area that includes all counties in which the corporation is located, or any county contiguous to such a county, including contiguous counties located outside of the Commonwealth of Pennsylvania. Each executive is also prohibited from soliciting corporation customers or employees, and from disclosing confidential or privileged information obtained in the course of employment with the corporation. Each executive acknowledges that all work product belongs to the corporation, and agrees to return any company property or documents obtained in the course of employment with the corporation. Both the corporation and each executive agree to the use of arbitration as the means for resolving contract disputes other than those concerning these restrictions and acknowledgements, which may be litigated.

The following table shows the potential payments and benefits payable to **Demetra M. Takes**, the corporation's Interim President and Chief Executive Officer, upon a separation of employment under terms of her employment agreement, assuming the event giving rise to such payment occurred on December 31, 2006.

| Form of Compensation | Death (1) | Disability | Reason for Separation | | | Change in Control | Other Involuntary |
|-----------------------------|--------------|------------|-----------------------|-------------|-------------------------------|-------------------|-------------------|
| | | | Cause | Good Reason | Voluntary, absent Good Reason | | |
| Salary/Severance | \$0 | \$126,972 | \$0 | \$309,960 | \$0 | \$619,920 | \$309,960 |
| Value of Employee Benefits | | | | | | | |
| Medical | \$0 | \$4,775 | \$0 | \$4,775 | \$0 | \$9,550 | \$4,775 |
| Dental | \$0 | \$335 | \$0 | \$335 | \$0 | \$670 | \$335 |
| Life | \$0 | \$960 | \$0 | \$960 | \$0 | \$1,920 | \$960 |
| Disability | \$0 | \$0 | \$0 | \$444 | \$0 | \$888 | \$444 |
| Vision | \$0 | \$60 | \$0 | \$60 | \$0 | \$120 | \$60 |
| 401(k) Match | \$0 | \$0 | \$0 | \$6,750 | \$0 | \$13,500 | \$0 |
| Pension Plan (2) | \$187,472 | \$374,944 | \$374,944 | \$374,944 | \$374,944 | \$374,944 | \$374,944 |
| SERP (3) | \$341,436(a) | \$0 | \$0 | \$89,441(b) | \$0(c) | \$89,441(d) | \$0 |
| Equity (4) | | | | | | | |
| Vested Stock Options | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Unexercisable Stock Options | \$0(a) | \$0(a) | \$0 | \$0(b) | \$0(b) | \$0(c) | \$0(b) |

(1) Does not include the proceeds from any employer-paid life insurance policies.

(2) Present value of accumulated benefit under the corporation's pension plan as of December 31, 2006, payable at normal retirement, age 65.

(3) Under the corporation's Supplemental Executive Retirement Plan, the executive is entitled to monthly benefits as follows:

- a. Death before retirement: Represents annualized first year benefit. The benefit is paid monthly to survivors in the amount of \$28,453 per month for the first 12 months following executive's death; then \$14,226 monthly from month 13 until the date that would have been the executive's 65th birthday, but not less than 120 months.
 - b. Good reason: Represents annualized benefit. The benefit is paid monthly as follows: At age 65, the executive receives the deferred vested benefit amounting to \$7,453 per month for life, but not less than 120 months.
 - c. Retirement: Not eligible at this time. Monthly retirement benefit is equal to 50%-times 1/60th of Ms. Takes' total annual compensation (including salary, overtime and bonus) from the company for her last 5 consecutive full calendar years of employment immediately preceding her retirement at or after age 65, less ½ of her monthly social security benefit, less the monthly income from the company's defined benefit pension plan, and less the projected monthly retirement income derived from the company's matching contributions to her 401(k). If she dies before receiving a minimum of 120 monthly retirement payments, the remaining payments will be paid to her beneficiary.
 - d. Change in control – Represents annualized benefit. Ms. Takes would be entitled to a deferred vested retirement benefit amounting to \$7,453 per month for life, but not less than 120 months. This benefit is payable when Ms. Takes reaches age 65 and calculated on compensation earned only while employed by the company. No benefits are payable if Ms. Takes voluntarily terminates her employment without Good Reason.
- (4) Based on the closing price of Harleysville National Corporation common stock as of December 31, 2006, \$19.31:
- a. Vesting of stock options does not accelerate upon death or disability. The optionee or the optionee's estate, as applicable, may exercise the vested portion of any outstanding awards for a period of one-year from the date of disability or death, as applicable, of the optionee. As of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Ms. Takes was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.
 - b. Vesting of stock options does not accelerate for any reason, except change in control. In the case of normal retirement, the optionee may exercise the vested portion of any outstanding awards for a period of 3 months from the date of retirement. As of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Ms. Takes was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.
 - c. Upon change in control, vesting accelerates and all outstanding options become immediately exercisable. However, as of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Ms. Takes was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.

In the event of a termination for good reason or involuntary termination absent cause, severance benefits to Ms. Takes equal one (1) times annual agreed compensation plus continuation of basic health & welfare and retirement benefits for a period of twelve months. Payments for disability include 70% of agreed compensation, less amounts payable under any disability plan of the corporation, plus benefit continuation until the earliest of (i) return to work, (ii) attainment of age 65, or (iii) death. In the event of her death, Ms. Takes' base salary will be paid through the end of the employment period. In the event of a termination related to a change of control, severance benefits are increased to 2.0 times annual agreed compensation plus continuation of health & welfare benefits for a corresponding period of months. There is no provision for payment in the event of her death.

The following table shows the potential payments and benefits payable to **George S. Rapp**, Executive Vice President and Chief Financial Officer, upon a separation of employment under terms of his employment agreement, assuming the event giving rise to such payment occurred on December 31, 2006.

| Form of Compensation | Reason for Separation | | | | | | |
|-----------------------------|-----------------------|------------|----------|-------------|-------------------------------------|----------------------|----------------------|
| | Death (1) | Disability | Cause | Good Reason | Voluntary, absent Good Reason | Change in Control | Other Involuntary |
| Salary/Severance | \$0 | \$41,075 | \$0 | \$187,250 | \$0 | \$374,500 | \$187,250 |
| Value of Employee Benefits | | | | | | | |
| Medical | \$0 | \$11,077 | \$0 | \$11,077 | \$0 | \$22,154 | \$11,077 |
| Dental | \$0 | \$646 | \$0 | \$646 | \$0 | \$1,292 | \$646 |
| Life | \$0 | \$158 | \$0 | \$719 | \$0 | \$1,438 | \$719 |
| Disability | \$0 | \$0 | \$0 | \$444 | \$0 | \$888 | \$444 |
| Vision | \$0 | \$96 | \$0 | \$96 | \$0 | \$192 | \$96 |
| Pension Plan (2) | \$8,645 | \$17,289 | \$17,289 | \$17,289 | \$17,289 | \$17,289 | \$17,289 |
| SERP (3) | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Equity (4) | | | | | | | |
| Vested Stock Options | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Unexercisable Stock Options | \$0(a) | \$0(a) | \$0 | \$0(b) | \$0(b) | \$0(c) | \$0(b) |

(1) Does not include the proceeds from any employer-paid life insurance policies.

(2) Present value of accumulated benefit under the corporation's pension plan as of December 31, 2006, payable at normal retirement, age 65.

(3) Currently not applicable to Mr. Rapp.

(4) Based on the closing price of Harleysville National Corporation common stock as of December 31, 2006, \$19.31.

a. Vesting of stock options does not accelerate upon death or disability. The optionee or the optionee's estate, as applicable, may exercise the vested portion of any outstanding awards for a period of one-year from the date of disability or death, as applicable, of

the optionee. As of December 31, 2006, intrinsic value of all outstanding exercisable options held by Mr. Rapp was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.

- b. Vesting of stock options does not accelerate for any reason, except change in control. In the case of normal retirement, the optionee may exercise the vested portion of any outstanding awards for a period of 3 months from the date of retirement. As of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Mr. Rapp was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.
- c. Upon change in control, vesting accelerates and all outstanding options become immediately exercisable. However, as of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Mr. Rapp was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.

In the event of a termination for good reason or involuntary termination absent cause, severance benefits to Mr. Rapp equal 1 times annual agreed compensation plus continuation of basic health & welfare benefits for a period of twelve months. Payments for disability include 70% of agreed compensation, less amounts payable under any disability plan of the corporation, plus benefit continuation until the earliest of (i) return to work, (ii) attainment of age 65, or (iii) death; one year is illustrated. There is no provision for payment in the event of his death. In the event of a termination related to a change of control, severance benefits are increased to 2 times annual agreed compensation plus continuation of health & welfare benefits for a corresponding period of months.

The following table shows the potential payments and benefits payable to **Michael B. High**, Executive Vice President and Chief Operating Officer, upon a separation of employment under terms of his employment agreement, assuming the event giving rise to such payment occurred on December 31, 2006.

| Form of Compensation | Death (1) | Disability | Cause | Reason for Separation | | Change in Control | Other Involuntary |
|-----------------------------|--------------|------------|----------|-----------------------|-------------------------------|-------------------|-------------------|
| | | | | Good Reason | Voluntary, absent Good Reason | | |
| Salary/Severance | \$352,500 | \$107,400 | \$0 | \$282,000 | \$0 | \$843,180 | \$282,000 |
| Value of Employee Benefits | | | | | | | |
| Medical | \$0 | \$13,438 | \$0 | \$13,438 | \$0 | \$40,314 | \$13,438 |
| Dental | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Life | \$0 | \$960 | \$0 | \$960 | \$0 | \$2,880 | \$960 |
| Disability | \$0 | \$0 | \$0 | \$444 | \$0 | \$1,332 | \$444 |
| Vision | \$0 | \$159 | \$0 | \$159 | \$0 | \$477 | \$159 |
| Pension Plan (2) | \$21,757 | \$43,514 | \$43,514 | \$43,514 | \$43,514 | \$43,514 | \$43,514 |
| SERP (3) | \$250,944(a) | \$0 | \$0 | \$0 | \$0(b) | \$66,820(c) | \$0(d) |
| Equity (4) | | | | | | | |
| Vested Stock Options | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Unexercisable Stock Options | \$0(a) | \$0(a) | \$0 | \$0(b) | \$0(b) | \$0(c) | \$0(b) |

(1) Does not include the proceeds from any employer-paid life insurance policies.

(2) Present value of accumulated benefit under the corporation's pension plan as of December 31, 2006, payable at normal retirement, age 65.

(3) Under the corporation's Supplemental Executive Retirement Plan, the executive is entitled to monthly benefits as follows:

- a. Death before retirement: Represents annualized first year benefit. The benefit is paid monthly to survivors in the amount of \$20,912 per month for the first 12 months following executive's death; then \$7,320 monthly from month 13 until the date that would have been the executive's 65th birthday, but not less than 120 months.
- b. Retirement: Benefit is contingent upon completion of 5 years of employment. Monthly retirement benefit is equal to 35% times 1/60th of Mr. High's total annual compensation (including salary, overtime and bonus) from the company for his last 5 consecutive full calendar years of employment immediately preceding his retirement at or after age 65, less ½ of his monthly social security benefit, less the monthly income from the company's defined benefit pension plan, and less the projected monthly retirement income derived from the company's matching contributions to his 401(k). If he dies before receiving a minimum of 120 monthly retirement payments, the remaining payments will be paid to his beneficiary.
- c. Change in control - Represents annualized benefit. Mr. High would be entitled to a deferred vested monthly retirement benefit amounting to \$5,568 per month for life, but not less than 120 months. This benefit is payable when Mr. High reaches age 65 and calculated on compensation earned only while employed by the company.
- d. Other Involuntary - If Mr. High's employment is terminated after 5 years of employment but prior to age 65, he would be entitled to a retirement benefit at an accrued rate of 3.5% of his average monthly compensation per years of service.

(4) Based on the closing price of Harleysville National Corporation common stock as of December 31, 2006, \$19.31.

- a. Vesting of stock options does not accelerate upon death or disability. The optionee or the optionee's estate, as applicable, may exercise the vested portion of any outstanding awards for a period of one-year from the date of disability or death, as applicable, of the optionee. As of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Mr. High was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.
- b. Vesting of stock options does not accelerate for any reason, except change in control. In the case of normal retirement, the optionee may exercise the vested portion of any outstanding awards for a period of 3 months from the date of retirement. As of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Mr. High was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.

- c. Upon change in control, vesting accelerates and all outstanding options become immediately exercisable. However, as of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Mr. High was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.

In the event of a termination for good reason or involuntary termination absent cause, severance benefits to Mr. High equal 1 times annual agreed compensation plus continuation of basic health & welfare benefits for a period of twelve months. Payments for disability include 70% of agreed compensation, less amounts payable under any disability plan of the corporation, plus benefit continuation until the earliest of (i) return to work, (ii) attainment of age 65, or (iii) death; one year is illustrated. In the event of his death, Mr. High's base salary will be paid through the end of the Employment Period. In the event of a termination related to a change of control, severance benefits are increased to 2.99 times annual agreed compensation plus continuation of health & welfare benefits for a corresponding period of months.

The following table shows the potential payments and benefits payable to **John W. Eisele**, Executive Vice President and President, Millennium Wealth Management & Private Banking, a division of Harleysville National Bank, upon a separation of employment under terms of his employment agreement, assuming the event giving rise to such payment occurred on December 31, 2006.

| Form of Compensation | Death (1) | Disability | Cause | Reason for Separation | | Change in Control | Other Involuntary |
|-----------------------------|--------------|------------|----------|-----------------------|-------------------------------|-------------------|-------------------|
| | | | | Good Reason | Voluntary, absent Good Reason | | |
| Salary/Severance | \$0 | \$79,435 | \$0 | \$242,050 | \$0 | \$484,100 | \$242,050 |
| Value of Employee Benefits | | | | | | | |
| Medical | \$0 | \$14,163 | \$0 | \$14,163 | \$0 | \$28,326 | \$14,163 |
| Dental | \$0 | \$1,051 | \$0 | \$1,051 | \$0 | \$2,102 | \$1,051 |
| Life | \$0 | \$929 | \$0 | \$929 | \$0 | \$1,859 | \$929 |
| Disability | \$0 | \$0 | \$0 | \$444 | \$0 | \$888 | \$444 |
| Vision | \$0 | \$159 | \$0 | \$159 | \$0 | \$318 | \$159 |
| Pension Plan (2) | \$14,404 | \$28,808 | \$28,808 | \$28,808 | \$28,808 | \$28,808 | \$28,808 |
| SERP (3) | \$248,940(a) | \$0 | \$0 | \$0 | \$0(b) | \$54,247(c) | \$0 |
| Equity (4) | | | | | | | |
| Vested Stock Options | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Unexercisable Stock Options | \$0(a) | \$0(a) | \$0 | \$0(a) | \$0(a) | \$0(a) | \$0(a) |

- (1) Does not include the proceeds from any employer-paid life insurance policies.
- (2) Present value of accumulated benefit under the corporation's pension plan as of December 31, 2006, payable at normal retirement, age 65.
- (3) Under the corporation's Supplemental Executive Retirement Plan, Mr. Eisele's benefits commence upon a triggering event and attainment of age 73. The executive is entitled to monthly benefits as follows:
- Death before retirement: Represents annualized first year benefit. The benefit is paid monthly to survivors in the amount of \$20,745 per month for the first 12 months following executive's death; then \$6,223 monthly from month 13 until the date that would have been the executive's 65th birthday, but not less than 120 months.
 - Retirement: Benefit is contingent upon completion of 5 years of employment. Monthly retirement benefit is equal to 30% times 1/60th of Mr. Eisele's total annual compensation (including salary, overtime and bonus) from the company for his last 5 consecutive full calendar years of employment immediately preceding his retirement at or after age 65, less ½ of his monthly social security benefit, less the monthly income from the company's defined benefit pension plan, and less the projected monthly retirement income derived from the company's matching contributions to his 401(k). If he dies before receiving a minimum of 120 monthly retirement payments, the remaining payments will be paid to his beneficiary.
 - Change in control – Represents annualized benefit. Mr. Eisele would be entitled to a deferred vested monthly retirement benefit amounting to \$4,521 per month for life, but not less than 120 months. This benefit is payable when Mr. Eisele reaches age 73 and calculated on compensation earned only while employed by the company.
 - Other Involuntary – If Mr. Eisele's employment is terminated after 5 years of employment but prior to age 73, he would be entitled to a retirement benefit at an accrued rate of 3.0% of his average monthly compensation per years of service.
- (4) Based on the closing price of Harleysville National Corporation common stock as of December 31, 2006, \$19.31.
- Currently not applicable to Mr. Eisele.

In the event of a termination for good reason or involuntary termination absent cause, severance benefits to Mr. Eisele equal 1 times annual agreed compensation plus continuation of basic health & welfare benefits for a period of twelve months. Payments for disability include 70% of agreed compensation, less amounts payable under any disability plan of the corporation, plus benefit continuation until the earliest of (i) return to work, (ii) attainment of age 65, or (iii) death; one year is illustrated. There is no provision for payment in the event of his death. In the event of a termination related to a change of control, severance benefits are increased to 2 times annual agreed compensation plus continuation of health & welfare benefits for a corresponding period of months.

The following table shows the potential payments and benefits payable to **James F. McGowan, Jr.**, Executive Vice President and Chief Credit Officer, upon a separation of employment under terms of his employment agreement, assuming the event giving rise to such payment occurred on December 31, 2006.

| Form of Compensation | Death (1) | Disability | Cause | Reason for Separation | | Change in Control | Other Involuntary |
|-----------------------------|--------------|------------|----------|-----------------------|-------------------------------|-------------------|-------------------|
| | | | | Good Reason | Voluntary, absent Good Reason | | |
| Salary/Severance | \$0 | \$28,003 | \$0 | \$160,000 | \$0 | \$320,000 | \$160,000 |
| Value of Employee Benefits | | | | | | | |
| Medical | \$0 | \$14,163 | \$0 | \$14,163 | \$0 | \$28,326 | \$14,163 |
| Dental | \$0 | \$1,051 | \$0 | \$1,051 | \$0 | \$2,102 | \$1,051 |
| Life | \$0 | \$614 | \$0 | \$614 | \$0 | \$1,229 | \$614 |
| Disability | \$0 | \$0 | \$0 | \$414 | \$0 | \$828 | \$414 |
| Vision | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Pension Plan (2) | \$10,833 | \$21,666 | \$21,666 | \$21,666 | \$21,666 | \$21,666 | \$21,666 |
| SERP (3) | \$157,056(a) | \$0 | \$0 | \$7,860(b) | \$0(c) | \$7,860(d) | \$0 |
| Equity (4) | | | | | | | |
| Vested Stock Options | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Unexercisable Stock Options | \$0(a) | \$0(a) | \$0 | \$0(b) | \$0(b) | \$0(c) | \$0(b) |

- (1) Does not include the proceeds from any employer-paid life insurance policies.
- (2) Present value of accumulated benefit under the corporation's pension plan as of December 31, 2006, payable at normal retirement, age 65.
- (3) Under the corporation's Supplemental Executive Retirement Plan, the executive is entitled to monthly benefits as follows:
 - a. Death before retirement: Represents annualized first year benefit. The benefit is paid monthly to survivors in the amount of \$13,088 per month for the first 12 months following executive's death; then \$6,544 monthly from month 13 until the date that would have been the executive's 65th birthday, but not less than 120 months.
 - b. Good reason: Represents annualized benefit. The benefit is paid monthly as follows: At age 65, the executive receives the deferred vested monthly benefit amounting to \$655 for life, but not less than 120 months.
 - c. Retirement: Not eligible at this time. Monthly retirement benefit is equal to 50% times 1/60th of Mr. McGowan's total annual compensation (including salary, overtime and bonus) from the company for his last 5 consecutive full calendar years of employment immediately preceding his retirement at or after age 65, less ½ of his monthly social security benefit, less the monthly income from the company's defined benefit pension plan, and less the projected monthly retirement income derived from the company's matching contributions to his 401(k). If he dies before receiving a minimum of 120 monthly retirement payments, the remaining payments will be paid to his beneficiary. No benefits are payable if Mr. McGowan voluntarily terminates his employment without Good Reason.
 - d. Change in control – Represents annualized benefit. Mr. McGowan would be entitled to a deferred vested monthly retirement benefit amounting to \$655 per month for life, but not less than 120 months. This benefit is payable when Mr. McGowan reaches age 65 and calculated on compensation earned only while employed by the company.
- (4) Based on the closing price of Harleysville National Corporation common stock as of December 31, 2006, \$19.31.
 - a. Vesting of stock options does not accelerate upon death or disability. The optionee or the optionee's estate, as applicable, may exercise the vested portion of any outstanding awards for a period of one-year from the date of disability or death, as applicable, of the optionee. As of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Mr. McGowan was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.
 - b. Vesting of stock options does not accelerate for any reason, except change in control. In the case of normal retirement, the optionee may exercise the vested portion of any outstanding awards for a period of 3 months from the date of retirement. As of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Mr. McGowan was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.
 - c. Upon change in control, vesting accelerates and all outstanding options become immediately exercisable. However, as of December 31, 2006, the intrinsic value of all outstanding exercisable options held by Mr. McGowan was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2006.

In the event of a termination for good reason or involuntary termination absent cause, severance benefits to Mr. McGowan equal 1 times annual agreed compensation plus continuation of basic health & welfare benefits for a period of twelve months. Payments for disability include 70% of agreed compensation, less amounts payable under any disability plan of the corporation, plus benefit continuation until the earliest of (i) return to work, (ii) attainment of age 65, or (iii) death; one year is illustrated. There is no provision for payment in the event of his death. In the event of a termination related to a change of control, severance benefits are increased to 2 times annual agreed compensation plus continuation of health & welfare benefits for a corresponding period of months.

Executive Employment Agreements

Demetra M. Takes

In 1998 the corporation and Harleysville National Bank entered into an employment agreement with Demetra M. Takes, Executive Vice President, Harleysville and President and Chief Executive Officer, Harleysville National Bank (the "Takes Employment Agreement").

The Takes Employment Agreement is for a term of 3 years, renewing automatically at the end of the three-year period for an additional one-year term. The employment agreement renews automatically at the end of each one-year extension. Either party must provide at least 180 days written notice prior to an annual renewal date in the event this agreement shall terminate at the end of the then existing employment period. The agreement specifies position title and duties, compensation and benefits, and indemnification and termination provisions. The executive will be entitled to participate in annual and long-term incentive plans and employee benefit plans, receive annual vacation in accordance with the policies established by the Board of Directors of the corporation, and receive an automobile and maintenance of such automobile. If the executive is terminated or upon occurrence of other events following a "Change in Control," as defined in the agreement, she may receive up to 2.0 times her agreed compensation and may continue participation in employee benefit plans. The Takes Employment Agreement also contains a non-competition provision and a confidentiality provision.

James F. McGowan and George S. Rapp

Effective August 2004, Harleysville Management Services, LLC, entered into an employment agreement with James F. McGowan, Jr. upon his employment as Executive Vice President and Chief Credit Officer of the bank and the corporation.

Harleysville Management Services, LLC, also entered into an employment agreement with George S. Rapp, effective May 2005 and amended December 15, 2006, pursuant to his employment as Executive Vice President and Chief Financial Officer of the bank and the corporation.

Each agreement is for a term of 2 years, renewing automatically at the end of the two-year period for an additional one-year term. The employment agreements renew automatically at the end of each one-year extension. Either party must provide at least 90 days written notice prior to an annual renewal date in the event this agreement shall terminate at the end of the then existing employment period. The agreement specifies position title and duties, compensation and benefits, and indemnification and termination provisions. The executives will be entitled to participate in annual and long-term incentive plans and employee benefit plans and to receive annual vacation in accordance with the policies established by the Board of Directors of Harleysville. Each executive also receives an automobile allowance. If either executive is terminated or upon occurrence of other events following a "Change in Control," as defined in the agreement, he may receive up to 2.0 times his agreed compensation and may continue participation in employee benefit plans. The agreements also contain a non-competition provision and a confidentiality provision.

Michael B. High

Effective April 1, 2005, Harleysville Management Services, LLC, entered into an employment agreement with Michael B. High, Executive Vice President and Chief Operating Officer of the corporation and Harleysville National Bank that is (the "High Employment Agreement").

The High Employment Agreement is for a term of 3 years and will automatically extend for one additional year at the end of the first three years and on every anniversary of the High Employment Agreement, unless notice to terminate is given 90 days prior to renewal. The executive is entitled to participate in annual and long-term incentive plans and employee benefit plans, receive 4 weeks of vacation each year, and receive a car allowance. The High Employment Agreement will automatically terminate for "Cause," as defined in the agreement, and all rights under the agreement will terminate. The High Employment Agreement will automatically terminate if the executive terminates the agreement for "Good Reason," as defined in the agreement, or is terminated by the corporation without cause and the executive will receive (1) the greater of the compensation they would receive for remainder of the agreements' term or one year's compensation and (2) participation in the corporation's benefit

plans for twelve months. The High Employment Agreement will automatically terminate upon the executive's disability, as defined in the agreement, and he will receive employee benefits and an amount no greater than 70% of his compensation less amounts payable under any disability plan until he (1) returns to work, (2) reaches 65, or (3) dies. The High Employment Agreement will automatically terminate upon the death of the executive and any compensation remaining for the term of the agreement will be paid to the executive's survivors. The High Employment Agreement will automatically terminate upon voluntary termination of the agreement by the executive absent "Good Cause," as defined in the agreement. If the executive is terminated or upon occurrence of other events following a "Change in Control," as defined in the agreement, the executive may receive up to 2.99 times his agreed compensation and will continue participation in employee benefit plans. The High Employment Agreement contains restrictive covenants precluding the executive from engaging in competitive activities in a certain area and provisions preventing the executive from disclosing proprietary information about the corporation.

John W. Eisele

Effective September 27, 2004, Harleysville Management Services, LLC, entered into an employment agreement with John W. Eisele upon his employment as Executive Vice President of the corporation and Harleysville National Bank, and President, Millennium Wealth Management and Private Banking, a division of Harleysville National Bank (the "Eisele Employment Agreement").

The Eisele Employment Agreement is for a term of 3 years, renewing automatically at the end of the three-year period for an additional one-year term. The employment agreement renews automatically at the end of each one-year extension. Either party must provide at least 90 days written notice prior to an annual renewal date, in the event this agreement shall terminate at the end of the then existing employment period. The Eisele Employment Agreement specifies position title and duties, compensation and benefits, and indemnification and termination provisions. The executive will be entitled to participate in annual and long-term incentive plans and employee benefit plans and to receive annual vacation in accordance with the policies established by the Board of Directors of Harleysville. Mr. Eisele also receives an automobile allowance. If the executive is terminated or upon occurrence of other events following a "Change in Control," as defined in the agreements, he may receive up to 2.0 times his agreed compensation and may continue participation in employee benefit plans. The agreement also contains a non-competition provision and a confidentiality provision.

Related Party Transactions

Certain directors and officers of the corporation, their immediate family members and companies with which they are associated, are customers of the corporation's banking subsidiary, Harleysville National Bank. During 2006, these individuals, family members and companies had banking transactions with Harleysville National Bank in the ordinary course of business. Similar transactions are expected to occur in the future. All loans and loan commitments involved in such transactions were made in the ordinary course of business under substantially the same terms, including interest rates, collateral, and repayment terms, as those prevailing at the time for comparable transactions with other persons. In the opinion of the corporation's management, these transactions do not involve more than the normal risk of collection, nor do they present other unfavorable features. Each of these transactions was made in compliance with applicable law, including Section 13(k) of the Securities and Exchange Act of 1934 and Federal Board Regulation O. As of December 31, 2006, loans to executive officers, directors, and their affiliates represented 5.9% of total shareholders' equity in the corporation.

Harleysville National Bank has established written policy and procedures for the review, approval and/or ratification of all related party transactions. These transactions are reported to and reviewed by Risk Management and approved and/or ratified by the independent members of the Board of Directors.

Section 16(a) Beneficial Ownership Reporting Compliance

The rules of the Securities and Exchange Commission require that the corporation disclose late filings of reports of stock ownership (and changes in stock ownership) by its directors and executive officers. To the best of the corporation's knowledge, there were no delinquent Section 16(a) filings during 2006.

Report of the Audit Committee

The Audit Committee ("Committee") oversees the corporation's financial reporting process on behalf of the Board of Directors. In that connection, the Committee, along with the Board of Directors, has formally adopted an audit committee charter setting forth its responsibilities. In addition, appropriate policies have been established to further strengthen disclosure procedures required under Sarbanes-Oxley Act of 2002.

Management has the primary responsibility for the financial statements and the reporting process including the systems of internal control. In fulfilling its oversight responsibilities, the Committee reviewed the audited financial statements in the Annual Report with management including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments and the clarity of disclosures in the financial statements.

The Committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgments as to the quality, not just the acceptability, of the corporation's accounting principles and such other matters as are required to be discussed with the Committee under generally accepted auditing standards. In addition, the Committee has discussed with the independent auditors the auditors' independence from management and the corporation including the matters in the written disclosures required by the Independence Standards Board and considered the compatibility of non-audit services with the auditors' independence.

The Committee discussed with the corporation's internal and independent auditors the overall scope and plans for their respective audits. The Committee meets with the internal and independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the corporation's internal controls and the overall quality of the corporation's financial reporting. During fiscal year 2006, the Committee held nine meetings which included four conference calls to review earnings prior to their public release.

In reliance in the reviews and discussions referred to above, the Committee recommended to the Board of Directors (and the Board has approved) that the audited financial statements be included in the Annual Report on Form 10-K for the year ended December 31, 2006 for filing with the Securities and Exchange Commission.

Audit Committee

Walter E. Bateman II, Chairman

LeeAnn B. Bergey

Thomas C. Leamer

James A. Wimmer

Independent Registered Public Accounting Firm

Grant Thornton LLP, Certified Public Accountants, a registered public accounting firm, of Philadelphia, Pennsylvania, served as Harleysville National Corporation's independent Registered Public Accounting Firm for the 2006 fiscal year. Grant Thornton LLP assisted the corporation and its subsidiaries with:

- preparation of federal and state tax returns, and
- assistance in connection with regulatory matters,

charging the banking subsidiaries for such service at its customary hourly billing rates. Aggregate fees billed to Harleysville National Corporation and subsidiaries by the independent accountants for services rendered during the fiscal year ending December 31, 2006, were as follows:

| Types of Fees | 2006 | 2005 |
|-------------------------|------------------|------------------|
| Audit Fees: (1) | \$350,259 | \$329,368 |
| Audit Related Fees: (2) | \$ 37,756 | \$ 45,018 |
| Tax Fees: (3) | \$144,415 | \$143,750 |
| All Other Fees: (4) | -0- | -0- |
| TOTAL | \$532,430 | \$518,136 |

- (1) Audit fees consisted of audit work performed in the preparation of financial statements, Sarbanes-Oxley Sec. 404 certification work, as well as work generally only the independent registered public accounting firm can reasonably be expected to provide, such as statutory audit and registration statements.
- (2) Audit related fees consisted principally of audits of employee benefit plans and student loan audits.
- (3) Tax fees consisted principally of assistance with matters related to tax compliance and reporting as well as assistance in the development of a management services company.
- (4) No other fees in 2006.

The Audit Committee pre-approves all audit and permissible non-audit services provided by the independent certified public accountants. These services may include audit services, audit related services, tax services, and other services. The Audit Committee has adopted a policy for the pre-approval of services provided by the independent certified public accountants. Under the policy, pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of particular services on a case-by-case basis. The Audit Committee approved all services provided by Grant Thornton, during 2006 and 2005.

The Audit Committee has approved and appointed Grant Thornton LLP, Certified Public Accounts, a registered public accounting firm, as the corporation's auditors for the fiscal year ending December 31, 2007. The Board of Directors of Harleysville National Corporation has ratified this appointment. Grant Thornton has advised the corporation that none of its members has any financial interests in Harleysville National Corporation.

Representatives of Grant Thornton will be present at the annual meeting. They will be given the opportunity to make a statement, if they desire to do so, and will be available to respond to appropriate questions after the meeting.

Electronic Distribution

You may choose to receive future distributions of Harleysville's material (quarterly reports, proxy statements, annual reports, etc.) via e-mail. Please follow your broker instructions to receive Harleysville's material electronically or you may go to www.hncbank.com, select Investor Information and click on "E-Mail Notification" from the list at the top of the page. After appropriately completing and submitting the form, you will be notified each time new information is released and becomes available on this website. You will be able to view the documents by clicking on "Documents" and following instructions, as prompted. If you need help with this, please call us at (215) 256-8851 and ask for Shareholder Services.

Annual Report

A copy of the corporation's annual report for the fiscal year ended December 31, 2006 accompanies this proxy statement. We furnish the annual report for your information only. We have not incorporated the annual report, or any part of the annual report, in this proxy statement.

Legal Proceedings

In the opinion of the management of the corporation, there are no proceedings pending to which the corporation is a party or to which its property is subject, which, if determined adversely to the corporation, would be material in relation to the corporation's undivided profits or financial condition. There are no proceedings pending other than routine litigation incident to the business of the corporation and its banking subsidiaries. In addition, no material proceedings are pending or are known to be threatened or contemplated against the corporation by government authorities.

Householding

We have adopted a procedure approved by the SEC called "householding." Under this procedure, multiple shareholders who share the same last name and address and do not participate in electronic delivery will receive only one copy of the proxy materials, unless they notify us that they wish to continue receiving multiple copies. We have undertaken householding to reduce our printing costs and postage fees.

If you wish to continue to receive multiple copies of the proxy materials at the same address, additional copies will be provided promptly to you upon request. You may request multiple copies by notifying us in writing or by telephone at:

Harleysville National Corporation
ATTN: Shareholder Services
483 Main Street
P. O. Box 195
Harleysville, PA 19438-0195
Telephone (215) 256-8851 or toll-free @ 800-423-3955

You may opt-out of householding at any time prior to thirty days before the mailing of proxy materials in March of each year by notifying us at the address above.

If you share an address with another shareholder and currently are receiving multiple copies of the proxy materials, you may request householding by notifying us at the above-referenced address or telephone number.

Discretionary Voting Authority

In connection with Harleysville's 2008 annual meeting and pursuant to SEC Rule 14a-4 under the Securities Exchange Act of 1934, if the shareholder's notice is not received by Harleysville on or before February 7, 2008, the Corporation (through management proxy holders) may exercise discretionary voting authority when the proposal is raised at the annual meeting without any reference to the matter in the proxy statement.

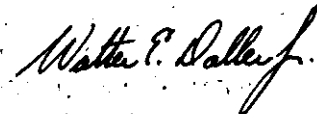
Additional Information

Any shareholder may obtain a copy of Harleysville National Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2006, including the financial statements and the schedules thereto, required to be filed with the Securities and Exchange Commission, without charge, by submitting a written request to Liz Chemnitz, Senior Vice President and Assistant Secretary of the corporation, Harleysville National Corporation, 483 Main Street, P.O. Box 195, Harleysville, Pennsylvania 19438-0195, telephone 800-423-3955. You may also view these documents on our website at www.hncbank.com, select Investor Information, and then click on "Documents/Filings."

Other Matters

The Board of Directors does not know of any matters to be presented for consideration other than the matters described in the accompanying Notice of Annual Meeting of Shareholders, but, if any matters are properly presented, persons named in the accompanying proxy intend to vote on such matters in accordance with their best judgment.

By Order of the Board of Directors,



Walter E. Daller, Jr.
Chairman of the Board

Date: March 22, 2007



Harleysville
NATIONAL CORPORATION
 HARLEYSVILLE NATIONAL CORPORATION
 483 MAIN STREET
 HARLEYSVILLE, PA 19438

**ANNUAL MEETING OF SHAREHOLDERS
 OF
 HARLEYSVILLE NATIONAL CORPORATION**
 Tuesday, April 24, 2007

VOTE BY INTERNET - www.proxyvote.com

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

ELECTRONIC DELIVERY OF FUTURE SHAREHOLDER COMMUNICATIONS

If you would like to reduce the costs incurred by Harleysville National Corporation in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access shareholder communications electronically in future years.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the cut-off date or meeting date. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Harleysville National Corporation, c/o ADP, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

HNCOR1

KEEP THIS PORTION FOR YOUR RECORDS

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

DETACH AND RETURN THIS PORTION ONLY

HARLEYSVILLE NATIONAL CORPORATION

**THE BOARD OF DIRECTORS RECOMMENDS A
 VOTE FOR THE ELECTION OF THE CLASS A
 DIRECTORS LISTED BELOW.**

1. TO ELECT TWO CLASS A DIRECTORS TO
 SERVE FOR FOUR-YEAR TERMS:

- 01) Harold A. Herr
 02) Stephanie S. Mitchell

For All Withhold For All
 All All Except

To withhold authority to vote for any individual nominee(s), mark "For All Except" and write the number(s) of the nominee(s) on the line below.

☐ ☐ ☐

2. In their discretion, the proxies are authorized to vote upon such other business as may properly come before the Annual Meeting and any adjournment or postponement thereof.

THIS PROXY, WHEN PROPERLY SIGNED, WILL BE VOTED IN THE MANNER DIRECTED HEREIN BY THE UNDERSIGNED SHAREHOLDER. IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED AS RECOMMENDED BY THE BOARD OF DIRECTORS.

PLEASE SIGN, DATE AND RETURN THIS PROXY CARD PROMPTLY IN THE ENCLOSED ENVELOPE.

Note: Please sign exactly as your name or names appear(s) on this Proxy. When shares are held jointly, each shareholder should sign. When signing as executor, administrator, attorney, trustee or guardian, please give full title as such. If the signer is a corporation, please sign full corporate name by duly authorized officer, giving full title as such. If signer is a partnership, please sign in partnership name by authorized person.

For address changes and/or comments, please check this box ☐
 and write them on the back where indicated.

Please indicate if you plan to attend this meeting. ☐ ☐
 Yes No

Signature [PLEASE SIGN WITHIN BOX] Date

Signature (Joint Owners) Date

Harleysville National Corporation
Annual Meeting - 9:30 a.m.
Breakfast - 8:30 a.m.
April 24, 2007

FOR YOUR CONVENIENCE - RETAIN FOR YOUR REFERENCE

Harleysville National Corporation will conduct its Annual Meeting of Shareholders on Tuesday, April 24, 2007, at 9:30 a.m. at Presidential Caterers, 2910 DeKalb Pike, Norristown, Pennsylvania 19401.

Breakfast will be served prior to the Annual Meeting, beginning at 8:30 a.m. The meeting will convene promptly at 9:30 a.m.

Please return your proxy vote if you have not already done so.

If you find that your plans have changed and you will be unable to join us for the annual meeting and breakfast, kindly call Harleysville National Corporation's Shareholder Services Department at 215-513-2305 and help us eliminate unnecessary charges. Thank you.

Directions to Presidential Caterers
2910 DeKalb Pike - Norristown, PA 19401
610-275-7300

NOTE TO ALL DRIVERS: There is a traffic island in the middle of the road on Route 202 just in front of Presidential's driveway so you CANNOT make a left turn off Route 202 into the driveway. You MUST enter the driveway with a right turn.

From King of Prussia - Take Route 202 North through Norristown to East Norriton. After crossing the intersection at Germantown Pike, the driveway to Presidential will be on your right.

From Montgomeryville & Lansdale - Take Route 202 South to East Norriton. Turn right at Township Line Road (CVS Pharmacy on corner). Go one block and turn left at Swede Road. Proceed to Germantown Pike and turn left. Second light, Route 202 (DeKalb Pike) turn left. Driveway to Presidential will be on your right.

From Philadelphia - Take Schuylkill Expressway to Plymouth Meeting. Exit Route 476 North to Germantown Pike-West Exit. Follow Germantown Pike-West to Route 202 North (DeKalb Pike). Make a right onto Route 202; driveway to Presidential will be on your right.

From Main Line - Take 476 North (Blue Route) to Germantown Pike-West Exit. Follow Germantown Pike-West to Route 202 North (DeKalb Pike). Make a right onto Route 202; driveway to Presidential will be on your right.

From Willow Grove - Take PA-Turnpike (Route 276) to Norristown Exit. Follow Germantown Pike-West to Route 202 North (DeKalb Pike). Make a right onto Route 202; driveway to Presidential will be on your right.

HARLEYSVILLE NATIONAL CORPORATION

REVOCABLE PROXY

**ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON APRIL 24, 2007
THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS**

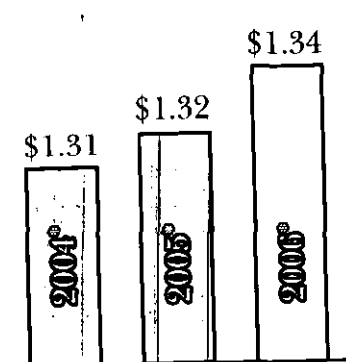
The undersigned hereby constitutes and appoints Tracie A. Young, Senior Vice President, Chief Compliance Officer and Louis P. Spinelli, Executive Vice President and each or any of them, proxies of the undersigned, with full power of substitution, to vote all of the shares of Harleysville National Corporation (the "Corporation") which the undersigned may be entitled to vote at the Annual Meeting of Shareholders of the Corporation to be held at Presidential Caterers, 2910 DeKalb Pike, Norristown, PA 19401, on Tuesday, April 24, 2007, at 9:30 a.m., prevailing time, and at any adjournment or postponement thereof, as follows:

Address Changes/Comments: _____

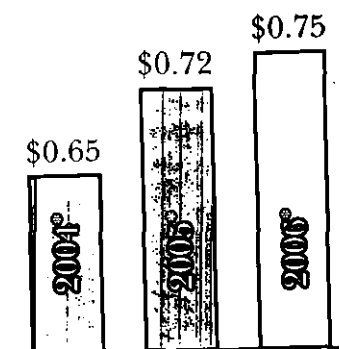
(If you noted any Address Changes/Comments above, please mark corresponding box on the reverse side.)

PLEASE SIGN, DATE AND RETURN THIS PROXY CARD PROMPTLY IN THE ENCLOSED ENVELOPE.

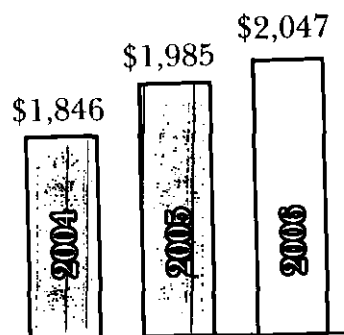
(Continued and to be signed on the reverse side)



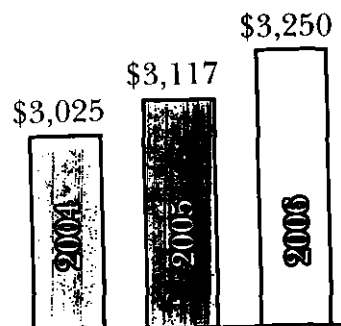
DILUTED EARNINGS
(per share)



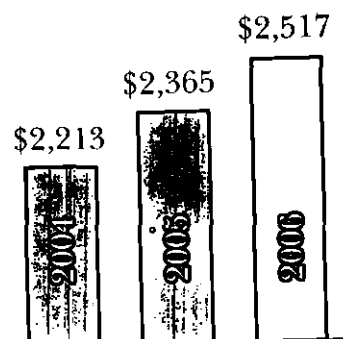
CASH DIVIDENDS
(per share)



LOANS
(in millions)



TOTAL ASSETS
(in millions)



DEPOSITS
(in millions)

*Adjusted for a five percent stock dividend effective 9/15/06, 9/15/05 and 9/15/04.

Corporate Information

Copies of the Corporation's Annual Report to the Securities and Exchange Commission (Form 10-K) are available, without charge, to shareholders online at www.hncbank.com. Copies may also be requested in writing. Direct correspondence to: Liz Chemnitz, Senior Vice President and Assistant Corporate Secretary, Administrator, Shareholder Services, 483 Main Street, P.O. Box 195, Harleysville, PA 19438. For information on our financial services solutions visit www.harleysvillebank.com or call 1-888-HNB-2100. You may also contact Millennium Wealth Management and Private Banking at www.mwmpb.com or 1-888-611-7400.

Annual Meeting

The 2007 Annual Meeting of Shareholders of Harleysville National Corporation will be held at Presidential Caterers, Norristown, PA, on Tuesday, April 24, 2007, at 9:30 a.m.

Nasdaq National Market Makers

As of December 31, 2006, the following firms made a market in the Corporation's common stock: UBS Securities LLC, Goldman Sachs & Co., Ferris, Baker Watts, Inc., Janney Montgomery LLC, Lehman Brothers Inc. and Boenning & Scattergood, Inc.

Stock Listing

Harleysville National Corporation common stock is traded under the symbol HNBC. The stock is commonly quoted under NASDAQ National Market Issues. At the close of business on December 31, 2006, there were 3,561 shareholders of record.

Dividend Reinvestment Plan

The Corporation has a Dividend Reinvestment and Stock Purchase Plan. Interested shareholders can obtain more information or register for this service by contacting American Stock Transfer & Trust Company. The American Stock Transfer dividend reinvestment number is 1-800-278-4353. It is different from their shareholder services number, 1-800-937-5449.

Dividend Direct Deposit

Shareholders not participating in the Dividend Reinvestment Plan may opt to have their dividends deposited directly into their checking or savings account at any financial institution participating in the Automated Clearing House (ACH) system. To register, contact American Stock Transfer & Trust Company.

Auditors

Grant Thornton LLP, Two Commerce Square,
2001 Market St., Suite 3100, Philadelphia, PA 19103,
215-561-4200

Registrar/Transfer Agent

American Stock Transfer & Trust Company,
59 Maiden Lane, New York, NY 10038, 1-800-937-5449

Harleysville National Corporation Board of Directors

| | |
|---------------------------------|-----------------------|
| Walter E. Daller, Jr., Chairman | Stephanie S. Mitchell |
| Walter R. Bateman, II | A. Ross Myers |
| LecAnn B. Bergey | Demetra M. Takes |
| Harold A. Herr | James A. Wimmer |
| Thomas C. Leamer | William M. Yocum* |

* Director Emeritus

Executive Officers as of December 31, 2006

Walter E. Daller, Jr., *Chairman, Harleysville National Corporation; Chairman, Harleysville National Bank*

Demetra M. Takes, *Interim President and Chief Executive Officer, Harleysville National Corporation; President and Chief Executive Officer, Harleysville National Bank*

Michael B. High, *Executive Vice President and Chief Operating Officer, Harleysville National Corporation; Executive Vice President, Chief Operating Officer, Harleysville National Bank*

George S. Rapp, *CPA, Executive Vice President and Chief Financial Officer, Harleysville National Corporation; Executive Vice President and Chief Financial Officer of Harleysville National Bank*

John W. Eisele, *Executive Vice President, Harleysville National Corporation; President, Millennium Wealth Management & Private Banking*

Lewis C. Cyr, *Executive Vice President, Harleysville National Corporation; Executive Vice President and Chief Lending Officer, Harleysville National Bank*

James F. McGowan, *Executive Vice President, Harleysville National Corporation; Executive Vice President and Chief Credit Officer, Harleysville National Bank*

END

